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The Authority of a Labor Arbitrator to Decide Legal Issues Under a Collective Bargaining Contract: The Situation After Alexander v. Gardner-Denver

MARVIN HILL, JR.*

I. BACKGROUND AND INTRODUCTION

In enacting the Labor-Management Relations (Taft-Hartley) Act (LMRA), Congress specifically recognized the arbitration process.[1] However, legislative and judicial acceptance and recognition of the arbitration process was long in coming. Courts initially made no effort to accommodate the labor arbitration process, considering it to be competitive with the court system, and hence, a process which should be discouraged.[2] After passage of the Arbitration Act,[3] courts agreed that they had the power to enforce arbitration agreements in collective bargaining contracts.[4] The applicability of the Arbitration Act to collective bargaining agreements became something of a moot issue after *Textile Workers v. Lincoln Mills of Alabama*,[5] which held that section 301[6] of the LMRA provides a body of

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The author wishes to express his appreciation to Professor William Buss of the University of Iowa College of Law for his assistance in the preparation of this Article.

[1]Section 203(d) of the Labor Management Relations Act, Pub. L. No. 101, 61 Stat. 136 (1947) (current version at 29 U.S.C. §§ 141-197 (1970 & Supp. V 1975)), provides that "[f]inal adjustment by a method agreed upon by the parties is hereby declared to be the desirable method for settlement of grievance disputes arising over the application or interpretation of an existing collective-bargaining agreement."

[2]*See, e.g.*, U.S. Asphalt Ref. Co. v. Trinidad Lake Petroleum Co., 222 F. 1006 (S.D.N.Y. 1915); International Ass'n of Machinists v. Cutler-Hammer, Inc., 271 App. Div. 917, 67 N.Y.S. 2d 317, *aff'd*, 297 N.Y. 519, 74 N.E.2d 464 (1947) (if meaning of provision of contract sought to be arbitrated is beyond dispute, there cannot be anything to arbitrate; function of court to determine whether dispute is subject to arbitration).

[3]9 U.S.C. §§ 1-14 (1970).

[4]*E.g.*, Hoover Motor Express Co. v. Teamsters Local 327, 217 F.2d 49 (6th Cir. 1954).

[5]353 U.S. 448 (1957).

[6]29 U.S.C. § 185 (1970). Section 301(a) of the Labor Management Relations Act provides:

> Suits for violation of contracts between an employer and a labor organization representing employees in an industry affecting commerce as defined in this

substantive law for the enforcement of collective bargaining agreements. Subsequently, the Supreme Court established the primacy of grievance arbitration as a mechanism for the resolution of industrial disputes in the famous *Steelworkers Trilogy.*[7]

Federal courts have limited the scope of judicial review of arbitration awards by holding that the award is not reviewable on the merits[8] and may be set aside only upon a showing of fraud or gross

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chapter, or between any such labor organizations, may be brought in any district court of the United States having jurisdiction of the parties, without respect to the amount in controversy or without regard to the citizenship of the parties.

[7]United Steelworkers v. American Mfg. Co., 363 U.S. 564 (1960); United Steelworkers v. Warrior & Gulf Navigation Co., 363 U.S. 574 (1960); United Steelworkers v. Enterprise Wheel & Car Corp., 363 U.S. 593 (1960).

[8]*See* United Steelworkers v. Enterprise Wheel & Car Corp., 363 U.S. 593 (1960). *But cf.* Hines v. Anchor Motor Freight, Inc., 424 U.S. 554 (1976) (proof of breach of the union's duty of fair representation held to remove the bar of finality from an arbitral decision). In *Hines*, petitioner-plaintiffs, who were employed as truck drivers by Anchor Motor Freight, were discharged for allegedly seeking reimbursement for motel expenses in excess of the actual charges sustained by them. The union claimed that petitioners were innocent, and opposed the discharge, based on the applicable collective bargaining contract which forbade discharges, except for just cause. In accordance with the collective bargaining contract, the matter was submitted to a joint arbitration committee, consisting of an equal number of union and company representatives, which found that the discharges were for just cause. Petitioners later discovered that the motel clerk had falsified the motel records, had recorded on the registration card less than was actually paid by the discharged employees, and had retained for himself the difference between the amount receipted and the amount recorded. Petitioners then filed suit for one million dollars damages from their employer and the local and international unions, alleging that the employer wrongfully discharged the petitioners from their jobs and that the unions represented their grievance in bad faith.

The district court granted summary judgment for the union and company, finding that the issue had been finally decided in arbitration and that the plaintiffs had failed to show sufficient facts to find "bad faith," "arbitrariness," or "perfunctoriness" in the union's conduct. Hines v. Local 377, Int'l Bhd. of Teamsters, 84 L.R.R.M. 2649 (N.D. Ohio 1973), *aff'd sub nom.* Hines v. Anchor Motor Freight, Inc., 506 F.2d 1153 (6th Cir. 1974), *rev'd*, 424 U.S. 554 (1976). The Court of Appeals for the Sixth Circuit reversed the summary judgment as to the local union, holding that the issue of bad faith should not have been summarily decided, that there were sufficient facts from which bad faith or arbitrary conduct could be inferred by the trier of fact, and that the employees should have been afforded an opportunity to prove their charges. However, the court of appeals affirmed the judgment in favor of the company, citing the finality provision of the collective bargaining agreement. Hines v. Anchor Motor Freight, Inc., 506 F.2d 1153 (6th Cir. 1974). The decision of the court of appeals with respect to Anchor was appealed to the United States Supreme Court and limited to the following question: "[w]hether petitioner's claim under LMRA [Taft-Hartley] § 301 for wrongful discharge is barred by the decision of a joint grievance committee upholding their discharge, notwithstanding that their union breached its duty of fair representation in processing their grievance so as to deprive them and the grievance committee of over-

misconduct.[9] As stated in *Hines v. Anchor Motor Freight, Inc.*,[10] "[C]ourts are not to usurp those functions which collective bargaining contracts have properly 'entrusted to the arbitration tribunal,'" but rather "should defer to the tribunal chosen by the parties finally to settle their disputes."[11] As indicated by the Supreme Court, to allow federal courts to review the merits of a dispute "would make meaningless the provisions that the arbitrator's decision is final, for in reality it would almost never be final."[12]

The National Labor Relations Board (NLRB)[13] has emphasized a strong federal labor policy favoring the collective bargaining mechanism for the resolution of industrial disputes. Section 10(a) of the LMRA[14] provides that the Board is empowered to prevent any person from engaging in any unfair labor practice and that this power shall not be affected by any other means of adjustment or prevention established by agreement. However, section 203(d) of the

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whelming evidence of their innocence of the alleged dishonesty for which they were discharged." 424 U.S. at 561 n.7. The Court stated that petitioners were not to be accorded the right to relitigate their discharge merely because they offered newly discovered evidence supporting the propositions that the charges against them were false and that they were, in fact, discharged without just cause. *Id.* at 571. However, the finality provision of a collective bargaining contract would not bar a subsequent relitigation when the employee's representation by the union has been dishonest, in bad faith, or discriminatory. Accordingly, if the employee could prove that the discharge was in fact erroneous and that the union's breach of duty had tainted the decision, the employee would have a remedy against the employer as well as the labor union. *Id.* at 567.

[9]For an excellent review of those instances under which a court will vacate the award of an arbitrator, see O. FAIRWEATHER, PRACTICE AND PROCEDURE IN LABOR ARBITRATION, ch. XVII (1973).

[10]424 U.S. 554 (1976).

[11]*Id.* 562-63 (quoting U.S. Steelworkers v. Enterprise Wheel & Car Corp., 363 U.S. 593, 599 (1960)).

[12]*Id.*

[13]The administration of the National Labor Relations Act, 29 U.S.C. §§ 151-168 (1970 & Supp. V 1975), is vested in an independent five-member agency known as the National Labor Relations Board. Members are appointed by the President with advice and consent from the Senate and are not subject to removal, except for neglect of duty or malfeasance in office. The Board is empowered to delegate to any group of three (a quorum) any or all of the powers which it may itself exercise. The Board has no rights and duties with respect to conciliation, mediation, or arbitration, nor has it jurisdiction over wage disputes, or authority to order the parties to enter into a contract or include specific terms therein. The main function of the Board is to process two categories of cases: representation cases and unfair labor practice cases. Representation cases arise under § 9, 42 U.S.C. § 159 (1970 & Supp. V 1975), and involve representation and selection of bargaining representatives by employees. Unfair labor practice (complaint) cases arise under § 10, 42 U.S.C. § 160 (1970 & Supp. V 1975), and are concerned with the prevention of employer and union unfair labor practices.

[14]*Id.* § 160(a).

LMRA also provides in part that "[f]inal adjustment by a method agreed upon by the parties is . . . the desirable method for settlement of grievance disputes arising over the applicaton or interpretation of an existing collective-bargaining agreement."[15] The Board has resolved the problem of harmonizing its duty under section 10(a) with its obligation to promote the private resolution of grievance disputes, which arguably may also be considered unfair labor practices, by formulating procedures under which it will defer either to an arbitration award previously issued[16] or defer to an arbitration process prior to the issuing of an award.[17]

In general, both the federal courts and the NLRB have favored the grievance-arbitration mechanism in resolving industrial disputes based on the principles of collectivity and rule by the majority.[18] For example, a union may decide not to process a grievance alleging a violation of the collective bargaining agreement because of doubts as to its merits or conflicts with other union interests. Under *Vaca v. Sipes*,[19] before an employee can maintain a suit for breach of contract against the employer, he must first demonstrate that the union breached its duty of fair representation. This requirement places a difficult burden of proof on the employee, especially in light of the test employed by the courts in finding a breach.[20] Thus, it appears

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[15]*Id.* § 173(d).

[16]In Spielberg Mfg. Co., 112 N.L.R.B. 1080 (1955), the Board held that "the desirable objective of encouraging the voluntary settlement of labor disputes will best be served" by the recognition of a prior arbitration award involving conduct which might constitute an unfair labor practice under § 8, 29 U.S.C. § 158 (1970 & Supp. V 1975), if the Board finds that: (1) [T]he arbitration proceedings "have been fair and regular," (2) all parties have agreed to be bound by the decision, and (3) "the decision . . . was not clearly repugnant to the purposes and policies of the [NLRA]." 112 N.L.R.B. at 1082. Later, in International Harvester Co., 138 N.L.R.B. 923 (1962), the Board refined these criteria in upholding an arbitration award which was not "palpably wrong," and where the proceedings were not "tainted by fraud, collusion, unfairness, or serious procedural irregularities." *Id.* at 928-29.

[17]In Joseph Schlitz Brewing Co., 175 N.L.R.B. 141 (1969), the Board indicated that it would not assert jurisdiction in deference to the grievance-arbitration machinery provided that certain criteria were met. The Board formulated the following requirements: (1) "[T]he contract clearly provides for grievance and arbitration machinery," (2) the conduct "is not designed to undermine the Union and is not patently erroneous but rather is based on a substantial claim of contractual privilege," and (3) "it appears that the arbitral interpretation of the contract will resolve both the unfair labor practice issue and the contract interpretation issue in a manner compatible with the purposes of the [NLRA]." *Id.* at 142. *See also* Collyer Insulated Wire, 192 N.L.R.B. 150 (1971).

[18]*See, e.g.*, Emporium Capwell Co. v. Western Addition Community Org., 420 U.S. 50 (1975); Vaca v. Sipes, 386 U.S. 171 (1967); J.I. Case v. NLRB, 321 U.S. 332 (1944).

[19]386 U.S. 171 (1967).

[20]The Supreme Court has established in Vaca v. Sipes, 386 U.S. 171 (1967), that a breach of the statutory duty occurs "when a union's conduct . . . is arbitrary, discrimi-

that a system which vests the union with virtually total control over the decision of whether to process a grievance—perhaps a necessity to the maintenance of a strong and effective collective bargaining and arbitration system—may, in the process, subvert the needs of a minority group or an individual employee attempting to end discriminatory employment practices.[21]

Title VII of the Civil Rights Act of 1964[22] exemplifies the conflict between a federal labor policy which emphasizes the private settle-

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natory, or in bad faith." *Id.* at 207. The arbitrary or bad-faith conduct requirement is not satisfied merely by showing that the employee has a meritorious grievance and that the union refused to process it to arbitration. However, as stated in *Vaca*, "[A] union may not arbitrarily ignore a meritorious grievance or process it in a perfunctory fashion." *Id.* at 191. The Court stated that "in administering the grievance and arbitration machinery as a statutory agent of the employees, a union must, in good faith and in a nonarbitrary manner make decisions as to the merits of a particular grievance." *Id.* at 194. *But see* Beriault v. Longshoremen Local 40, 501 F.2d 258 (9th Cir. 1974) (the duty to act "fairly" is breached when the union's actions are arbitrary; such actions need not be deceitful, dishonest, or in bad faith).

[21]"The collective bargaining system as encouraged by Congress and administered by the NLRB of necessity subordinates the interests of an individual employee to the collective interests of all employees in a bargaining unit." Vaca v. Sipes, 386 U.S. 171, 182 (1967). In addition, the Supreme Court has limited the ability of employees to avail themselves of self-help remedies. In Emporium Capwell Co. v. Western Addition Community Org., 420 U.S. 50 (1975), the Court held that picketing the premises of the employer and urging a consumer boycott in order to force the employer to bargain over alleged employment discrimination were unprotected activities under the LMRA, because the employees effectively bypassed the union and demanded that the Company bargain with the picketing employees for the entire group of minority employees. The Court rejected the argument that employees who seek to bargain separately with their employer over the elimination of racially discriminatory employment practices which peculiarly affected them should be free from the constraints of the exclusivity principle of § 9(a), 29 U.S.C. § 159(a) (1970). The employees cited the time-consuming nature of the grievance procedure and the national labor policy against discrimination as requiring this exception. The Court reasoned that "it is far from clear that separate bargaining is necessary to help eliminate discrimination." 420 U.S. at 66. In *Emporium* the collective bargaining agreement contained a provision prohibiting all manner of invidious discrimination without qualification and made any violation a grievable issue. In addition, the union was prepared to go to arbitration, and "[t]hat orderly determination, if affirmative, could lead to an arbitral award enforceable in court." *Id.* Furthermore, "[e]ven if the arbitral decision denies the putative discriminatee's complaint his access to the processes of Title VII and thereby to the federal courts is not foreclosed." *Id.* n.18.

[22]Civil Rights Act of 1964, §§ 701-718, 42 U.S.C. §§ 2000e to 2000e-17 (1970 & Supp. V 1975). Title VII of the Civil Rights Act of 1964 explicitly prohibits discrimination in employment as to hiring, firing, compensation, terms, conditions, or privileges of employment on the basis of race, color, religion, sex, or national origin. *Id.* § 2000e-2 (1970). It is now clear that white persons have a cause of action for employment discrimination under Title VII. McDonald v. Santa Fe Trail Transp. Co., 427 U.S. 273 (1976). Since 1972 the Act has applied to employers engaged in interstate commerce who have employed at least 15 employees during each working day in each of 20 or more calendar weeks of the current or preceding calendar year. 42 U.S.C. § 2000e(b)

ment of industrial disputes through the grievance-arbitration procedure and a national policy which attempts to eliminate employment discrimination. This conflict is intensified when a discriminatory act by an employer or labor organization constitutes a violation of Title VII[23] as well as a violation of the terms of a collective

(Supp. V 1975). It also applies to employment agencies procuring employees for such an employer, *id.* §§ 2000e(c), 2000e-2(b) (1970 & Supp. V 1975), and to almost all labor organizations, *id.* §§ 2000e-(d), 2000e-2(c) (1970). The 1972 amendments extended coverage to all state and local governments, government agencies, political subdivisions (except for elected officials, their personal assistants, and immediate advisors) and the District of Columbia departments and agencies (except where subject by law to the federal competitive service). *Id.* § 2000e(a), (f) (Supp. V 1975).

An aggrieved employee charging a violation of the Act must file a charge with the EEOC within 180 days after the alleged violation, unless the person has commenced a proceeding before an authorized state or local authority. 42 U.S.C. § 2000e-5(e) (Supp. V 1975). In the latter case, the charge must be filed within 300 days after the violation occurred or within 30 days after the person aggrieved has received notice that the deferral agency has terminated the proceeding, whichever is earlier. *Id.*

The reach of Title VII's prohibitions against employment discrimination has been expanded by the courts to include even neutrally stated and indiscriminately administered employment practices or procedures, in the absence of demonstrable business necessity, if the practice operates to favor an identifiable group of white employees over a protected class. Griggs v. Duke Power Corp., 401 U.S. 424 (1971).

Provision is made in the Act to preclude application of federal preemption to state or local laws assigned to proscribe employment discrimination. 42 U.S.C. § 2000e-7 (1970). Thus, if an individual initially processes an employment discrimination charge in a state or local forum and receives an adverse ruling (or fails to obtain a timely ruling), this does not bar him from subsequently bringing a Title VII action. *See, e.g.*, Cooper v. Phillip Morris, Inc., 464 F.2d 9 (6th Cir. 1972); Voutis v. Union Carbide Corp., 452 F.2d 889 (2d Cir. 1971).

[23]42 U.S.C. § 2000e-2(a) to (c) (1970) provides in part:

(a) Employer practices.

It shall be an unlawful employment practice for an employer—

(1) to fail or refuse to hire or to discharge any individual, or otherwise to discriminate against any individual . . . because of such individual's race, color, religion, sex, or national origin; or

(2) to limit, segregate, or classify his employees . . . in any way which would deprive or tend to deprive any individual of employment opportunities or otherwise adversely affect his status as an employee, because of such individual's race, color, religion, sex, or national origin.

. . . .

(c) Labor organization practices.

It shall be an unlawful employment practice for a labor organization—

(1) to exclude or to expel from its membership, or otherwise to discriminate against, any individual because of his race, color, religion, sex, or national origin;

(2) to limit, segregate, or classify its membership . . . in any way which would deprive or tend to deprive any individual of employment opportunities, or . . . otherwise adversely affect his status as an employee . . . because of such individual's race, color, religion, sex, or national origin; or

(3) to cause or attempt to cause an employer to discriminate against an individual in violation of this section.

bargaining agreement. For example, an individual covered under a labor agreement may allege that the employer has violated the terms of the agreement by discharging the employee for something other than "just cause."[24] If, at the same time, the employee alleges that the discharge was based on race or some other criterion proscribed by Title VII, he may commence an action under that statute. The Supreme Court held in *Alexander v. Gardner-Denver Co.*[25] that an arbitral award does not bar a concurrent or subsequent suit in federal court alleging discrimination under Title VII.[26] Effectively this means that the employee may file a grievance pursuant to the terms of a collective bargaining agreement and concurrently or subsequently assert a Title VII claim in another forum. In declining to hold that an arbitral determination would bar a Title VII suit, the *Alexander* Court was especially cognizant of the arbitrator's task in

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[24]Grounds for discharge, either in the form of a "just cause" limitation or a listing of specific offenses for which one may be disciplined or discharged, are mentioned in approximately 97% of labor contracts. [1976] LABOR RELATIONS EXPEDITOR (BNA) 131. Frequency figures are based on a sample of 400 representative union contracts in effect during 1973-74.

[25]415 U.S. 36 (1974).

[26]Prior to the Supreme Court's ruling in Alexander v. Gardner-Denver Co., *id.*, the federal courts were split in attempting to resolve the conflict between the following "pro-" and "anti-bar" decisions, with the former holding that an arbitral determination operates as a bar to further action under Title VII, and the latter holding that an arbitrator's decision is not such a bar:

Pro-bar decisions: Rios v. Reynolds Metals Co., 467 F.2d 54 (5th Cir. 1972); Alexander v. Gardner-Denver Co., 466 F.2d 1209 (10th Cir. 1972), *rev'd*, 415 U.S. 36 (1974) (the Supreme Court took an anti-bar stand); Thomas v. Phillip Carey Mfg. Co., 455 F.2d 911 (6th Cir. 1972) (favorable arbitration award bars Title VII claim in federal court); Dewey v. Reynolds Metals Co., 429 F.2d 324 (6th Cir. 1970); Sanchez v. TWA, 8 Empl. Prac. Dec. 5075 (D.N.M. 1973), *rev'd and rem'd*, 499 F.2d 1107 (10th Cir. 1974) (decided consistently with the Supreme Court's decision in *Alexander*); Taylor v. Springmeier Shipping Co., 3 Empl. Prac. Dec. 7011 (W.D. Tenn. 1971) (resort to contract grievance procedure on claim of wrongful discharge amounted to election of remedies); Edwards v. North Am. Rockwell Corp., 291 F. Supp. 199 (C.D. Cal. 1968) (pursual of contract remedy to conclusion considered binding "election of remedies"); Washington v. Aerojet-General Corp., 282 F. Supp. 517 (C.D. Cal. 1968) (binding election of remedies made when grievant agreed to third step of grievance procedure to reduce one month's disciplinary layoff to nine days).

Anti-bar decisions: Franks v. Bowman Transp. Co., 495 F.2d 398 (5th Cir. 1974); Oubichon v. North Am. Rockwell Corp., 482 F.2d 569 (9th Cir. 1973); Macklin v. Spector Freight, Inc., 478 F.2d 981 (D.C. Cir. 1973) (policy of honoring private grievance decisions not to be followed where fairness of procedure attacked); Voutsis v. Union Carbide Corp., 452 F.2d 889 (2d Cir. 1971) (federal court can entertain complaint of sex discrimination despite settlement under a state fair employment practices provision); Newman v. Avco Corp., 451 F.2d 743 (6th Cir. 1971); Hutchings v. United States Indus., Inc., 428 F.2d 303 (5th Cir. 1970); Bowe v. Colgate-Palmolive Co., 416 F.2d 711 (7th Cir. 1969).

relation to the collective bargaining agreement. The Court noted that the labor arbitrator, as proctor of the bargain, has no general authority to invoke public laws that conflict with the agreement. Citing *United Steelworkers v. Enterprise Wheel & Car Corp.*,[27] the Court stated:

> If an arbitral decision is based solely on the arbitrator's view of the requirements of enacted legislation, rather than on an interpretation of the collective bargaining agreement, the arbitrator has exceeded the scope of his submission, and the award will not be enforced. Thus, the arbitrator has authority to resolve only questions of contractual rights, and this authority remains regardless whether certain contractual rights are similar to, or duplicative of, the substantive rights secured by Title VII.[28]

The obligation and authority of a labor arbitrator to interpret and apply the law in resolving conflicts arising under the labor agreement has been the subject of much debate.[29] This Article will explore and analyze the problems and issues arising when an arbitrator is presented with the opportunity to interpret and apply the law in resolving a contractual dispute, particularly those disputes which are cognizable under Title VII. Part II will review the positions taken by selected members of the National Academy of Arbi-

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[27]363 U.S. 593 (1960).

[28]415 U.S. at 53-54.

[29]*See generally* Cox, *The Place of Law in Labor Arbitration*, in THE PROFESSION OF LABOR ARBITRATION, SELECTED PAPERS FROM THE FIRST SEVEN ANNUAL MEETINGS OF THE NATIONAL ACADEMY OF ARBITRATORS, 1948-1954 at 76 (BNA 1957); Howlett, *The Role of Law in Arbitration; A Reprise*, in DEVELOPMENTS IN AMERICAN AND FOREIGN ARBITRATION; PROCEEDINGS OF THE TWENTY-FIRST ANNUAL MEETING, NATIONAL ACADEMY OF ARBITRATORS 64 (BNA 1968); Howlett, *The Arbitrator, the NLRB, and the Courts*, in THE ARBITRATOR, THE NLRB, AND THE COURTS; PROCEEDINGS OF THE TWENTIETH ANNUAL MEETING, NATIONAL ACADEMY OF ARBITRATORS 67 (BNA 1967); Meltzer, *The Role of Law in Arbitration; Rejoinders*, in DEVELOPMENTS IN AMERICAN AND FOREIGN ARBITRATION; PROCEEDINGS OF THE TWENTY-FIRST ANNUAL MEETING, NATIONAL ACADEMY OF ARBITRATORS 58 (BNA 1968); Meltzer, *Ruminations About Ideology, Law, and Labor Arbitration*, in THE ARBITRATOR, THE NLRB, AND THE COURTS; PROCEEDINGS OF THE TWENTIETH ANNUAL MEETING, NATIONAL ACADEMY OF ARBITRATORS 1 (BNA 1967); Mittenthal, *The Role of Law in Arbitration*, in DEVELOPMENTS IN AMERICAN AND FOREIGN ARBITRATION; PROCEEDINGS OF THE TWENTY-FIRST ANNUAL MEETING, NATIONAL ACADEMY OF ARBITRATORS 42 (BNA 1968); St. Antoine, *The Role of Law in Arbitration: Discussion*, in DEVELOPMENTS IN AMERICAN AND FOREIGN ARBITRATION; PROCEEDINGS OF THE TWENTY-FIRST ANNUAL MEETING, NATIONAL ACADEMY OF ARBITRATORS 75 (BNA 1968); Sovern, *When Should Arbitrators Follow Federal Law?*, in ARBITRATION AND THE EXPANDING ROLE OF NEUTRALS; PROCEEDINGS OF THE TWENTY-THIRD ANNUAL MEETING, NATIONAL ACADEMY OF ARBITRATORS 29 (BNA 1970).

trators[30] and other authorities. Part III will focus on the analysis and reasoning provided by the Supreme Court in *Alexander*, with respect to the problems and policy considerations of arbitrators interpreting and applying the law when resolving grievances. Finally, Part IV will review selected cases subsequent to *Alexander* involving the general authority of arbitrators to decide Title VII-type grievances.

II. The Arbitrator and the Law: Deciding Legal Issues Under a Collective Bargaining Agreement

As indicated earlier, the obligation and authority of a labor arbitrator to interpret and apply the law when resolving grievances has been the subject of much debate.[31] Two situations are to be distinguished. In the first, the contractual and statutory standards are not in conflict, but overlap. In this case, few argue that arbitrators should ignore federal law when a contractual provision is ambiguous and can be interpreted in two ways—one consistent with the law and one inconsistent therewith. Meltzer[32] argues that in such a situation, there is not necessarily an incompatability between the statutory and contractual standard.

> [W]here a contractual provision is susceptible to two interpretations, one compatible with, and the other repugnant to, an applicable statute, the statute is a relevant factor for interpretation. Arbitral interpretation of agreements, like judicial interpretation of statutes, should seek to avoid a construction that would be invalid under a higher law.[33]

The second situation involves the case where a conflict exists between the agreement and the statute. The orthodox position is that an arbitrator's decision is constrained by the collective bargaining agreement; when there is conflict the arbitrator should respect the agreement and ignore the law. Meltzer, the leading exponent of this traditional view, has argued that arbitrators should respect the agreement, which is the source of their authority, leaving to the courts or other official tribunals the determination of whether the agreement contravenes a specific statute. Otherwise, arbitrators

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[30]The National Academy of Arbitrators was organized in 1947 in cooperation with the American Arbitration Association. In addition to setting standards for labor arbitrators, the Academy provides a forum for discussing problems of labor arbitration within the profession.

[31]*See* note 29 *supra* and accompanying text.

[32]Meltzer, *Ruminations About Ideology, Law, and Labor Arbitration*, *supra* note 29.

[33]*Id.* at 15.

would be deciding issues beyond the scope of not only the submission agreement, but also arbitral competence.[34] However, Meltzer would deem the arbitrator to be justified in resolving a legal question if the parties have requested the arbitrator to issue an additional advisory opinion[35] or if they intended to incorporate legal standards into the agreement.[36] Absent these special circumstances, Meltzer believes that an arbitrator who invokes the law to defeat the negotiated contract exceeds the authority conferred by the submission agreement.[37] As a final argument for the traditional view, Meltzer asserts that there is no reason to credit arbitrators with having any special legal competence.[38]

A contrary position is taken by Howlett,[39] who argues that "arbitrators *should* render decisions on the issues before them *based on both contract language and law.*"[40] This position is based on the following considerations: (1) The rationale that "each contract includes all applicable law," which becomes "part of the 'essence [of the] collective bargaining agreement' to which Mr. Justice Douglas has referred in [*Enterprise Wheel*],"[41] (2) the policy of the NLRB, as enunciated in *Spielberg*, favoring the arbitral determination of legal issues,[42] and (3) the notion that "an arbitrator who decides a dispute without consideration of legal issues disserves his management-union clients."[43] Indeed, under Howlett's view, an arbitrator is not only under a *duty* to apply substantive law, but is also under an affirmative *duty* to probe for a statutory violation. "Unless he does so, neither the General Counsel nor the Board will 'defer' to the arbitrator's decision."[44]

Several commentators have proposed solutions somewhere between the Meltzer and Howlett positions. Cox has argued that an arbitrator should look to the statutes in order to avoid rendering an award that would *require* the parties to violate the law.[45] This position, states Cox,

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[34]*Id.* at 16.

[35]*Id.* at 31.

[36]*Id.* at 15.

[37]*Id.* at 16-17.

[38]*Id.*

[39]Howlett, *The Arbitrator, the NLRB, and the Courts*, *supra* note 29.

[40]*Id.* at 83 (emphasis in original).

[41]*Id.* (citing United Steelworkers v. Enterprise Wheel & Car Corp., 363 U.S. 593 (1960)).

[42]*Id.* at 79 (citing Spielberg Mfg. Co., 112 N.L.R.B. 1080 (1955)).

[43]*Id.* at 85.

[44]*Id.* at 92.

[45]Cox, *The Place of Law in Labor Arbitration*, *supra* note 29, at 78.

> does not suggest that an arbitrator should pass upon all the parties' legal rights and obligations. It does not suggest that an arbitrator should refuse to give effect to a contract provision merely because the courts would not enforce it. Nor does it imply that an arbitrator should be guided by judge-made rules of evidence or contract interpretation. The principle requires only that the arbitrator look to see whether sustaining the grievances would require conduct the law forbids or would enforce an illegal contract; if so, the arbitrator should not sustain the grievance.[46]

In an address before the National Academy of Arbitrators in 1968, Mittenthal[47] refined Cox's position:

> On balance, the relevant considerations support Cox's view. The arbitrator should "look to see whether sustaining the grievance would require conduct the law forbids or would enforce an illegal contract; if so, the arbitrator should not sustain the grievance." This principle, however, should be carefully limited. It does not suggest that "an arbitrator should pass upon all the parties' legal rights and obligations" or that "an arbitrator should refuse to give effect to a contract provision merely because the courts would not enforce it." Thus, although the arbitrator's award may *permit* conduct forbidden by law but sanctioned by contract, it should not *require* conduct forbidden by law even though sanctioned by contract.[48]

Mittenthal cited several interesting examples which demonstrated the rationale behind his position, including the following, which was first proposed by Cox. After World War II a conflict developed between provisions of the Selective Service Act and contractual provisions of collective bargaining contracts dealing with seniority. The Supreme Court interpreted the Act to require employers to give veterans preference over nonveterans in the event of layoffs during the first year after their discharge from the armed forces,[49] while the common collective bargaining contract gave veterans only the seniority they would have had if they had not been drafted. The other example concerned a problem arising under the National Labor Relations Act. Without prior discussion with the union, an employer advanced the starting time at the plant pursuant to a con-

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[46] *Id.* at 79.

[47] Mittenthal, *The Role of Law in Arbitration*, *supra* note 29.

[48] *Id.* at 50.

[49] Fishgold v. Sullivan Corp., 328 U.S. 275 (1946).

tract which granted the employer "sole jurisdiction over all matters concerning the management of the plant subject only to the terms of the agreement." In the first example, the union filed a grievance when the employer released a nonveteran who had more contract seniority than a veteran. In the second, the union charged that the statutory rights and duties are a part of the contract and that the unilateral action was a violation of section 8(a)(5) of the LMRA, which makes it an unfair labor practice for the employer to refuse to bargain collectively with representatives of his employees.

Mittenthal would apply the Supreme Court ruling in the first example and deny the grievance because such an award would require the employer to engage in conduct forbidden by law. In the second hypothetical, he would sustain the grievance if there were no contract violation, for even if the employer's actions were contrary to law, the award would merely permit and not require illegal action. Mittenthal supports his position with the following reasoning:

> One of the reasons for this proposition [that arbitrators should consider the law to avoid an award which would *require* unlawful conduct] is that contracts contemplate 'final and binding' awards and that an award compelling unlawful conduct cannot really be 'final and binding.' The dispute over the contract, over the award itself, would continue into the courts.[50]

However, Mittenthal realizes that the arbitrator should, for the same reason, enforce statutory obligations because his failure to do so would likely result in a court suit.

> When an arbitrator refuses to enforce a statutory obligation, his award is 'final and binding' with respect to the contract. The grievant has no contract question to take to court. He may pursue his statutory rights in the appropriate forum, but such a suit has nothing to do with the contract.[51]

Sovern[52] offers a more detailed compromise to the debate, listing the following criteria which should be satisfied before an arbitrator entertains a legal issue:

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[50]Mittenthal, *The Role of Law in Arbitration*, *supra* note 29, at 52 n.37.

[51]*Id.* This author takes the position that the distinction which Mittenthal makes with respect to "permitting" and "requiring" a violation of the law is not functionally useful. As Meltzer notes, "[I]f the arbitrator is viewed as 'enforcing' contracts, he 'enforces' an illegal contract equally whether he causes an employer to engage in an act prohibited by statute or, by denying a remedy, condones the prohibited act already executed by the employer." Meltzer, *The Role of Law in Arbitration; Rejoinders*, *supra* note 29, at 60.

[52]Sovern, *When Should Arbitrators Follow Federal Law?*, *supra* note 29.

1. The arbitrator is qualified.
2. The question of law is implicated in a dispute over the application or interpretation of a contract that is also before him.
3. The question of law is raised by a contention that, if the conduct complained of does violate the contract, the law nevertheless immunizes or even requires it.
4. The courts lack primary jurisdiction to adjudicate the questions of law.[53]

Sovern notes that in a Title VII case, the fourth criterion is not met, "[s]ince the courts are entrusted with primary jurisdiction to decide Title VII questions. . . ."[54]

III. The Alexander Position

A. Background

In May 1966, Harrell Alexander was hired to perform maintenance at the plant of the Gardner-Denver Company. In June 1968, Alexander was awarded a trainee position as a drill operator where he remained until his discharge in September 1969. He was told that he was being discharged for producing too many defective parts.

On October 1, 1969, Alexander filed a grievance pursuant to the terms of the collective bargaining contract.[55] Under the agreement, the company retained the right to hire, suspend, or discharge employees for proper cause. The agreement also provided that "there shall be no discrimination against any employee on account of race, color, religion, sex, national origin, or ancestry,"[56] and that "no employee will be discharged, suspended or given a written warning notice except for just cause."[57] A broad arbitration clause was included to cover the differences between the company and the union as to the meaning and application of the provisions of the labor contract. Disputes were to be processed through a multi-step grievance procedure with final and binding arbitration as the last step.

The union processed Alexander's grievance through the above machinery. In a final prearbitration step, Alexander raised the claim, apparently for the first time, that his discharge resulted from

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[53] *Id.* at 38.

[54] *Id.* at 45.

[55] The grievance stated: "I feel I have been unjustly discharged and ask that I be reinstated with full seniority and pay." Alexander v. Gardner-Denver Co., 415 U.S. 36, 39 (1974).

[56] *Id.* at 39 n.1.

[57] *Id.* at 40-41 n.3.

racial discrimination. At the hearing, Alexander testified that his discharge was the result of racial discrimination and informed the arbitrator that because he could not rely on the union, he had filed a charge with the Colorado Civil Rights Commission.[58] In December, after an arbitration hearing, Alexander was found to have been discharged for just cause. The arbitrator's opinion made no reference to Alexander's claim of racial discrimination.

In June 1970, pursuant to a referral by the Colorado Civil Rights Commission, the EEOC determined that there was not reasonable cause to believe that a violation of Title VII had occurred. After being notified of his right to institute an action under the Civil Rights Act of 1964, Alexander filed an action in district court. Stating that the issue raised by the suit was the need to determine "just how many chances plaintiff should be afforded to try to establish his claim of discrimination," the district court granted summary judgment to the employer.[59]

In *Alexander*, the Supreme Court had to decide under what circumstances, if any, an employee's statutory right to a trial de novo

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[58]*Id.* at 42.

[59]Alexander v. Gardner-Denver Co., 346 F. Supp. 1012 (D. Colo. 1971), *aff'd*, 466 F.2d 1209 (10th Cir. 1972), *rev'd*, 415 U.S. 36 (1974). The lower court focused on the dichotomy of authority found in Dewey v. Reynolds Metals Co., 429 F.2d 324 (6th Cir. 1970), *aff'd by an equally divided court*, 402 U.S. 689 (1971), and Hutchings v. United States Indus., Inc., 428 F.2d 303 (5th Cir. 1970), and adopted, in their entirety, the views expressed in *Dewey*:

> We hold that when an employee voluntarily submits a claim of discrimination to arbitration under a union contract grievance procedure—a submission which is binding on the employer no matter what the result—the employee is bound by the arbitration award just as is the employer. We cannot accept a philosophy which gives the employee two strings to his bow when the employer has only one. Congress has given the employee one and one-half strings under the Equal Employment Opportunity procedure. It is true that the Commission can enter no order binding on the employer, but with a finding of probable cause, reserving to the employee the right to sue, he is given the assistance of an agency of the United States Government in attempting to bring about a settlement of the claimed discrimination. This amounts to a half string.
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> . . . To hold that an employee has a right to an arbitration of a grievance which is binding on an employer but is not binding on the employee—a trial balloon for the employee, but a moon shot for the employer—would sound the death knell for arbitration clauses in labor contracts. Such a result would bring to a tragic end the many years of effort which have brought about the now prevailing arbitration procedures to resolve labor disputes. The vital importance of the rights protected by the Civil Rights Act must not be overlooked, but it is the employee who elected arbitration. His was a voluntary choice, and he should be bound by it.

Alexander v. Gardner-Denver Co., 346 F. Supp. at 1019.

under Title VII is precluded by a prior submission of his claim to final arbitration. Hence, the Court was faced with two important, but conflicting national policies: encouragement of voluntary settlement of disputes through grievance-arbitration procedures negotiated by the parties, and elimination of employment discrimination.[60]

The Court noted the absence of any express authority in Title VII itself with respect to the relationship between federal courts and the grievance-arbitration machinery of collective bargaining agreements. However, the Court stated that prior legislative enactments[61] and the legislative history of Title VII[62] suggested a Congressional intent to allow an individual to pursue his rights independently under both Title VII and other applicable state and federal statutes. "The clear inference," reasoned the Court, "is that Title VII was designed to supplement, rather than supplant, existing

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[60]It is noteworthy that with respect to precedent, an equally divided Court had affirmed Dewey v. Reynolds Metals Co., 402 U.S. 689 (1971), three years earlier. In addition, the Supreme Court considered the relationship between contract and statutory remedies in United States Bulk Carriers, Inc. v. Arguelles, 400 U.S. 351 (1971). In *Bulk Carriers*, a seaman brought an action in district court under the Seaman's Act of 1790, § 6, 46 U.S.C. § 596 (1970), to recover wages allegedly due. The seaman was also subject to a collective bargaining agreement containing a grievance procedure with final arbitration as the last step. The Supreme Court held that the seaman was not required to exhaust his contractual remedies. In his concurring opinion, Justice Harlan recognized that the ultimate resolution of the conflict between statutory and contractual rights would proceed "with close attention to the policies underpinning both the duty to arbitrate and the provision by Congress of rights and remedies in alternative forums." 400 U.S. at 359.

[61]The Court cited the Civil Rights Act of 1870, ch. 114, § 16, 42 U.S.C. § 1981 (1970):

> All persons within the jurisdiction of the United States shall have the same right in every State and Territory to make and enforce contracts, to sue, be parties, give evidence, and to the full and equal benefit of all laws and proceedings for the security of persons and property as is enjoyed by white citizens, and shall be subject to like punishment, pains, penalties, taxes, licenses, and exactions of every kind, and to no other.

and the Civil Rights Act of 1871, ch. 22, § 1, 42 U.S.C. § 1983 (1970), which states the following:

> Every person who, under color of any statute, ordinance, regulation, custom, or usage, of any State or Territory, subjects, or causes to be subjected, any citizen of the United States or other person within the jurisdiction thereof to the deprivation of any rights, privileges, or immunities secured by the Constitution and laws, shall be liable to the party injured in an action at law, suit in equity, or other proper proceeding for redress.

[62]In support, the Court cited an interpretive memorandum by one of the sponsors of the bill containing Title VII which stated:

> Nothing in title VII or anywhere else in this bill affects rights and obligations under the NLRA and the Railway Labor Act. . . . [T]itle VII is not intended to and does not deny to any individual, rights and remedies which he

laws and institutions relating to employment discrimination."[63] The Court rejected the theory of "election-of-remedies" or "res judicata-collateral estoppel"[64] as a rationale for precluding relitigation. Analogous to the procedure under the National Labor Relations Act, where conduct may implicate both contractual and statutory rights, the Court held that the relationship between the forums is complementary, "since consideration of the claim by both forums may promote the policies underlying each."[65] The "separate nature of . . . contractual and statutory rights is not vitiated merely because both were violated as a result of the same factual occurrence."[66] In addition, the Court rejected the argument that an "election of remedies is required by the possibility of unjust enrichment through duplicative recoveries," for "even in cases where the employee has first prevailed, judicial relief can be structured to avoid such windfall gains."[67]

> may pursue under other Federal and State statutes. If a given action should violate both title VII and the National Labor Relations Act, the National Labor Relations Board would not be deprived of jurisdiction.

415 U.S. at 48 n.9 (quoting 110 CONG. REC. 7207 (1964)). The Court also discussed the legislative history of Title VII:

> Moreover, the Senate defeated an amendment which would have made Title VII the exclusive federal remedy for most unlawful employment practices. [A] similar amendment was rejected in connection with the Equal Employment Opportunity Act of 1972. The report of the Senate Committee responsible for the 1972 Act explained that neither the provisions regarding the individual's right to sue under title VII, nor any of the other provisions of this bill, . . . [were] meant to affect existing rights granted under other laws.

Id. (citations omitted).

[63] 415 U.S. at 48-49.

[64] *Id.* at 49. As noted by the Sixth Circuit in Tipler v. E. I. duPont deNemours & Co., 443 F.2d 125 (6th Cir. 1971), res judicata and collateral estoppel are different theories which often lead to the same result. The *Tipler* court noted:

> [A]pplication of the doctrine of res judicata necessitates an identity of causes of action, while the invocation of collateral estoppel does not. Each doctrine, on the other hand, requires that, as a general rule, both parties to the subsequent litigation must be bound by the prior judgment. The essence of collateral estoppel by judgment is that some question or fact in dispute has been judicially and finally determined by a court of competent jurisdiction between the same parties or their privies. Thus, the principle of such an estoppel may be stated as follows: Where there is a second action between parties, or their privies, who are bound by a judgment rendered in a prior suit, but the second action involves a different claim, cause, or demand, the judgment in the first suit operates as a collateral estoppel as to, but only as to, those matters or points which were in issue or controverted and upon the determination of which the initial judgment necessarily depended.

443 F.2d at 128 (quoting 1B MOORE'S FEDERAL PRACTICE ¶ 441[2] (2d ed. 1974) (footnotes omitted)).

[65] 415 U.S. at 50-51.

[66] *Id.* at 50.

[67] *Id.* at 51 n.14.

The Supreme Court also rejected "waiver" as a possible legal basis for the preclusion rule, stating that "[i]n no event can the submission to arbitration . . . under the nondiscrimination clause of a collective-bargaining agreement constitute a binding waiver with respect to an employee's rights under Title VII."[68] The Court's reasoning is instructive.

> It is true, of course, that a union may waive certain statutory rights related to collective activity, such as the right to strike. These rights are conferred on employees collectively to foster the processes of bargaining and properly may be exercised or relinguished by the union as collective-bargaining agent to obtain economic benefits for union members. Title VII, on the other hand, stands on plainly different ground; it concerns not majoritarian processes, but an individual's right to equal employment opportunities. Title VII's strictures are absolute and represent a congressional command that each employee be free from discriminatory practices. Of necessity, the rights conferred can form no part of the collective-bargaining process since waiver of these rights would defeat the paramount congressional purpose behind Title VII. In these circumstances, an employee's rights under Title VII are not susceptible of prospective waiver.[69]

Significantly, *Alexander* took an inflexible position in refusing to adopt a preclusion rule or a deferral standard. A deferral rule was viewed as laced with many of the objections applicable to a policy of preclusion. Nor would a more demanding deferral standard provide a solution.[70] In support of its position, the Court stated that deferral criteria which "adequately insured effectuation of Title VII rights

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[68] *Id.* at 52 n.15.

[69] *Id.* at 51-52 (citations omitted). With respect to the waiver argument, the Court further stated:

> The actual submission of petitioner's grievance to arbitration in the present case does not alter the situation. Although presumably an employee may waive his cause of action under Title VII as part of a voluntary settlement, mere resort to the arbitral forum to enforce contractual rights constitutes no such waiver. Since an employee's rights under Title VII may not be waived prospectively, existing contractual rights and remedies against discrimination must result from other concessions already made by the union as part of the economic bargain struck with the employer. It is settled law that no additional concession may be exacted from any employee as the price for enforcing those rights.

Id. at 52.

[70] 415 U.S. at 58. *Alexander* rejected the more demanding test adopted in Rios v. Reynolds Metals Co., 467 F.2d 54 (5th Cir. 1972).

would tend to make arbitration a procedurally complex, expensive, and time-consuming process."[71] Such a standard of review would effectively require courts to make de novo determinations of an employee's claim. In addition, a deferral rule was seen as adversely affecting the arbitral system. The Court noted that employees, "fearing that the arbitral forum cannot adequately protect their rights under Title VII, . . . may elect to bypass arbitration and institute a lawsuit."[72] This, reasoned the Court, would reduce voluntary compliance and settlement of Title VII claims, resulting in more, not less, litigation. Thus, while not adopting any "de jure" deferral standards, the Court stated that the arbitral decision "may be admitted as evidence and accorded such weight as the court deems appropriate."[73]

Lest anyone believe the Court had finally resolved the controversy, the following footnote was inserted:

> We adopt no standards as to the weight to be accorded an arbitral decision, since this must be determined in the court's discretion with regard to the facts and circumstances of each case. Relevant factors include the existence of provisions in the collective-bargaining agreement that conform substantially with Title VII, the degree of procedural fairness in the arbitral forum, adequacy of the record with respect to the issue of discrimination, and the special competence of particular arbitrators. Where an arbitral determination gives full consideration to an employee's Title VII rights, a court may properly accord it great weight. This is especially true where the issue is solely one of fact, specifically addressed by the parties and decided by the arbitrator on the basis of an adequate record. But courts should ever be mindful that Congress, in enacting Title VII, thought it necessary to provide a judicial forum for the ultimate resolution of discriminatory employment claims. It is the duty of courts to assure the full availability of this forum.[74]

It is especially noteworthy that throughout the opinion the Court focused on the role of arbitration "in a system of industrial

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[71]415 U.S. at 59. For a detailed analysis of the reasoning of the Court with respect to deference standards, *see* Hill, *The Effects of Non-Deference on the Arbitral Institution: An Alternative Theory*, 28 LAB. L.J. 230 (1977).

[72]415 U.S. at 59.

[73]*Id.* at 60.

[74]*Id.* at 60 n.21. Upon remand, the district court found that Alexander had in fact been discharged for just cause. Alexander v. Gardner-Denver Co., 8 Empl. Prac. Cas. 1153 (D. Colo. 1974), *aff'd*, 519 F.2d 503 (10th Cir. 1975).

government,"[75] as well as some of the institutional deficiencies of the arbitration process. The Court felt that the arbitral institution was a comparatively inappropriate forum for *final* resolution of Title VII rights. This conclusion was based on the following considerations: (1) The role of the arbitrator is to effectuate the intent of the parties; (2) because the arbitrator's authority is the collective bargaining agreement, any conflict between Title VII and the agreement must be resolved in favor of the agreement;[76] (3) the specialized competence of arbitrators lies primarily in the law of the shop, not in the law of the land;[77] (4) arbitral fact-finding is not equivalent to

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[75]415 U.S. at 52.

[76]*Id.* at 56-57.

[77]*Id.* The extent to which arbitrators possess the expertise to decide legal issues in employment discrimination cases has been the subject of empirical investigation. One study randomly selected members of the National Academy of Arbitrators and attempted (by questionnaire) to determine the views of arbitrators with respect to their expertise in handling legal issues. Of the 79 members returning the questionnaire, 18% felt competent and expert about interpreting the provisions of a collective bargaining agreement in accordance with Title VII, 47% believed themselves competent, and 31% responded that they would rather avoid the legal issue; 4% had no opinion. The figures were 23, 58, 13, and 6%, respectively, for those respondents who were also lawyers. Note, *The Authority and Obligation of a Labor Arbitrator to Modify or Eliminate a Provision of a Collective Bargaining Agreement Because in His Opinion it Violates Federal Law*, 32 OHIO ST. L.J. 395 (1971).

Of the 200 Academy members responding to a 1975 survey, only 52% indicated that they read advance sheets to keep current with respect to Title VII developments, nearly 40% answered that they did not read the sheets, and 8% declined to answer. Only 72% indicated that they felt professionally competent to decide legal issues in cases involving claims of race, sex, national origin, or religious discrimination. Sixteen percent answered that they did not feel competent, and 12% declined to answer the question. *See* Edwards, *Arbitration of Employment Discrimination Cases: An Empirical Study*, in PROCEEDINGS OF THE TWENTY-EIGHTH ANNUAL MEETING OF THE NATIONAL ACADEMY OF ARBITRATORS 59 (BNA 1976).

What is especially interesting is Edwards' finding that of the 83% who indicated that they had never read a judicial opinion involving a claim of employment discrimination, 50% of this same group nevertheless answered that they felt professionally competent to decide legal issues in discrimination grievances. One-half of those who felt they were not professionally competent to decide legal issues also answered that they had heard and decided employment discrimination cases during the past year.

The above data, especially Edwards' findings, appear to support *Alexander's* concern with the expertise and competence of labor arbitrators to decide legal issues, and especially those involving employment discrimination. Edwards reasoned that there would be little interest in the question of the competence and expertise of arbitrators if only qualified arbitrators were being selected. However, based on the survey data, such is not the case. The existing selection processes fail to screen out persons who are not professionally qualified to decide legal issues.

It is noteworthy that arbitrators themselves are supportive of the *Alexander* rationale. Approximately two-thirds of the responding arbitrators in the Edwards study adopted Meltzer's position, *see* notes 32-38 *supra* and accompanying text, that an ar-

judicial fact-finding;[78] (5) the record of the arbitration proceeding is generally incomplete relative to that of a court; the usual rules of evidence do not apply; and the rights and procedures common to civil trials, such as discovery, compulsory process, cross-examination, and testimony under oath, are often severely limited or unavailable;[79] (6) arbitrators have no obligation to the court to give reasons for an award;[80] (7) the general informality of the arbitration procedure relative to the court system makes it a less appropriate forum for final resolution of Title VII issues;[81] and (8) the interests of an individual employee may be subordinated to the collective interests of all employees in an arbitration hearing, due in part to (a) the union's exclusive control over the manner and extent to which an individual grievance is presented;[82] (b) the lack of "harmony of interest" between union and employer, given a charge of racial discrimination against the former; and (c) the difficulty of establishing a breach of the duty of fair representation.[83]

B. Alexander and the Authority of the Arbitrator

The *Alexander* decision has resolved little of the Meltzer-Howlett-Cox-Mittenthal debate. The Court, in dicta, merely cited the dicta in *Enterprise Wheel*[84] and stated that the arbitrator has authority to resolve only questions of contractual rights.[85] Presum-

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bitrator has no business applying a statute in a contract-grievance dispute. In addition, 85% of those respondents felt that an arbitrator may consider and interpret public law in order to avoid compelling the parties to violate the law. But at the same time, Edwards found that more than one-third of the arbitrators disagreed with the result in *Alexander*, which, argues Edwards, is inherently illogical.

[78]415 U.S. at 57.

[79]*Id.* at 57-58.

[80]*Id.* at 58.

[81]*Id.*

[82]*Id.* n.19 (citing Vaca v. Sipes, 386 U.S. 171 (1967), and Republic Steel Corp. v. Maddox, 379 U.S. 650 (1965)).

[83]*Id.*

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> [A]n arbitrator is confined to interpretation and application of the collective bargaining agreement; he does not sit to dispense his own own brand of industrial justice. He may of course look for guidance from many sources, yet his award is legitimate only so long as it draws its essence from the collective bargaining agreement. When the arbitrator's words manifest an infidelity to this obligation, courts have no choice but to refuse enforcement of the award.

415 U.S. at 53 (quoting United Steelworkers v. Enterprise Wheel & Car Corp., 363 U.S. 593, 597 (1960)).

[85]"Thus the arbitrator has authority to resolve only questions of contractual rights, and this authority remains regardless of whether certain contractual rights are

ably, under *Alexander*, no legal infirmity would result in the situation where an arbitrator, faced with an ambiguous contract, looks to Title VII for guidance in resolving the dispute. Indeed, the Supreme Court in *Enterprise Wheel* contemplated that the arbitrator would look for guidance from many sources, including the law.[86]

Where the question does *not* require choosing one of two interpretations of an ambiguous provision—one consistent with the law, the other inconsistent—arbitrators are entitled to rest their decisions squarely on the law if the parties have granted the arbitrator such authority, either by contract or submission agreement.[87] As an example, the parties may execute a contract incorporating the provisions of Title VII, in which case the arbitrator would be within his authority in basing the award on his interpretation of Title VII. Here again, *Alexander* would not preclude the arbitrator from deciding the Title VII issue; the Court states that when the collective bargaining agreement contains a nondiscrimination clause similar to Title VII, arbitration may well produce a satisfactory settlement.[88] When no explicit discrimination clause similar to Title VII is present, most collective bargaining agreements will contain a "just cause" restriction with respect to discipline or discharge.[89] Accordingly, an arbitrator may well invalidate conduct by an employer based on criteria prohibited by Title VII. Even if a contract does not contain any limitation on the right to discipline or discharge, some arbitrators have held that a "just cause" term is implied.[90] Hence, in the last two examples, where the arbitrator has not been given the contractual authority to apply the law, an aggrieved employee may still be afforded an adequate remedy in the arbitral forum. Again, *Alexander* does not preclude this result.

In the difficult situation where the arbitrator has not been given the authority to apply the law, and he feels that the arbitral award

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similar to, or duplicative of, the substantive rights secured by Title VII." 415 U.S. at 53-54.

[86]*See* note 84 *supra*.

[87]*See* O. FAIRWEATHER, *supra* note 9, at 111.

[88]415 U.S. at 55. *See also* Goodyear Tire and Rubber Co. v. Rubber Workers Local 200, 42 Ohio St. 2d 516, 330 N.E.2d 703 (1975) (arbitrator had authority to modify contract pursuant to EEOC guidelines where contract provided for modification by federal statute).

[89]Grounds for discharge, either in the form of a "just cause" limitation or a listing of specific offenses for which one may be disciplined or discharged, are mentioned in approximately 97% of contracts. Frequency figures are based on a sample of 400 representative union contracts in effect during 1973-74. [1976] LABOR RELATIONS EXPEDITOR (BNA) 131.

[90]*E.g.*, Cameron Iron Works, Inc., 25 Lab. Arb. & Disp. Settl. 295 (1955); *contra*, Okenite Co., 22 Lab. Arb. & Disp. Settl. 756, 760-61 (1954).

would conflict with Title VII if he were to follow the agreement instead of the law, *Alexander* appears to mandate that the arbitrator follow the agreement. The Court states that "[w]here the collective-bargaining agreement conflicts with Title VII, the arbitrator must follow the agreement."[91]

At this juncture some elaboration is needed. *Alexander* indicates that the arbitrator can resolve "only questions of contractual rights, and this authority remains regardless of whether certain contractual rights are similar to, or duplicative of, the substantive rights secured by Title VII."[92] An arbitrator who is not explicitly granted the power by a collective bargaining agreement to apply the law and is faced with a contract which "requires" or "permits" a violation of Title VII must, under *Alexander*, follow the agreement. This is not to say that under *Alexander* the arbitrator cannot resolve the dispute consistently with Title VII. Arguably, the arbitrator who determines that the agreement, in fact, incorporates "the law" may well resolve the dispute consistently with Title VII on the theory that the parties did not intend to negotiate an agreement that is contrary to law. However, in drafting the opinion, the arbitrator must be especially cognizant of the dicta in *Enterprise Wheel:* "[The] award is legitimate only so long as it draws its essence from the collective bargaining agreement. When the arbitrator's words manifest an infidelity to this obligation, courts have no choice but to refuse enforcement of the award."[93] An award invalidating a discriminatory employment practice based solely on what the arbitrator believes to be required by Title VII will not be enforced; arguably such an award does not "draw its essence from the collective bargaining agreement."[94] If the opinion of the arbitrator "is based solely upon the arbitrator's view of the requirements of the enacted legislation," he has exceeded the scope of his submission.[95]

In absence of specific authority to incorporate the law, the arbitrator, under *Alexander* and *Enterprise Wheel*, must make clear that his award is based upon the collective bargaining agreement, and not upon his application of Title VII. Of course, under *Enterprise Wheel* the arbitrator may look to the law for help in determining the sense of the agreement.[96] Such "reaching out" for the law by

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[91]415 U.S. at 57.

[92]*Id.* at 53-54.

[93]363 U.S. at 597.

[94]*Id.*

[95]*Id.*

[96]Such language as "I, the arbitrator, sustain the grievance on the basis of Section 703 of Title VII, Griggs v. Duke Power Corp., and the recent EEOC Guidelines on Testing," may not withstand a subsequent court challenge. However, the following language would probably withstand a challenge in the courts:

the arbitrator is also permitted by *Alexander*, but again, the arbitrator must carefully word the opinion so as to indicate that his decision is, in fact, based upon the agreement.

IV. Title VII—The Grievance Procedure and the Authority of the Arbitrator: Recent Case Law

The *Alexander* Court recognized the possibility that employment discrimination cases may, under certain circumstances, be adequately resolved in grievance and arbitration proceedings.

> Where the collective bargaining agreement contains a nondiscrimination clause similar to Title VII and where procedures are fair and regular, arbitration may well produce a settlement satisfactory to both employer and employee. . . . [A]rbitration may often eliminate those misunderstandings or discriminatory practices that might otherwise precipitate resort to the judicial forum.[97]

Although it seems clear that *Alexander* does not require exhaustion of the grievance procedure prior to initiating a Title VII action,[98] the Court found no infirmity in those cases where arbitrators resolve Ti-

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> [T]his grievance is upheld on the grounds that the agreement does not permit the employer to promote on the basis of data obtained from an invalidated test, which, although fair on its face, operates to discriminate on the basis of race, and furthermore, my findings appear to be consistent with Title VII.

[97]415 U.S. at 55.

[98]Courts have held that an employee need not exhaust the grievance and arbitration procedure contained in a collective bargaining agreement before commencing a Title VII action. King v. Georgia Power Co., 295 F. Supp. 943 (N.D. Ga. 1968); Dent v. St. Louis Ry., 265 F. Supp. 56 (N.D. Ala. 1967); Reese v. Atlantic Steel Co., 282 F. Supp. 905 (N.D. Ga. 1967). The issue of exhaustion is not entirely foreclosed by *Alexander*, where the Supreme Court never explicitly addressed the issue. Additionally, the facts of *Alexander* do not lend themselves to a definitive holding, because Alexander had exhausted his contractual remedies prior to initiating a suit in federal court. However, prior decisions by the Supreme Court, *e.g.*, United States Bulk Carriers, Inc. v. Arguelles, 400 U.S. 351 (1971), as well as the language of *Alexander*, indicate that an employee need not resort to the grievance procedure before initiating a Title VII suit. *Alexander* correctly noted that Title VII does not speak explicitly to the relationship between the federal courts and the grievance procedure, but instead it "[vests] the federal courts with plenary powers to enforce the statutory requirements; and it specifies with precision the jurisdictional prerequisites that an individual must satisfy before he is entitled to institute a lawsuit." 415 U.S. at 47. The Court stated that in the present case, these prerequisites were met when the petitioner filed a timely charge of employment discrimination with the EEOC, and received and acted upon the Commission's statutory notice of the right to sue. In light of the overall emphasis in *Alexander* on the separate nature of contractual rights under the grievance procedure and statutory rights under Title VII, there is little reason to believe that the Court implicitly held that exhaustion was required. Subsequent to *Alexander*, the courts that

tle VII-type grievances pursuant to their authority under the agreement.[99]

Courts that have considered the issue of arbitral authority subsequent to *Alexander*[100] have not always resolved the issue consistently with that decision. In *Southbridge Plastics Division v. Rubber Workers Local 759*,[101] a federal court granted the employer an injunction against the union processing the grievances of the employees to arbitration. The employees were alleging a layoff which was in violation of the terms of the collective bargaining agreement. The company had previously been the subject of an EEOC complaint filed by certain female employees alleging sex discrimination with respect to its hiring policies and job classification system. The EEOC found the system of departmental- and plant-wide seniority, provided for in the agreement, unlawful because it perpetuated the effects of past sex discrimination. Accordingly, the company and the EEOC entered into a conciliation agreement which would effectively shield women from the effects of the past discriminatory practices.[102] After refusing to sign the agreement, the union

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have considered the exhaustion issue have invariably held that an employee need not exhaust his or her contractual remedies before initiating a Title VII action. Leone v. Mobile Oil Corp., 523 F.2d 1153 (D.C. Cir. 1975); Waters v. Wisconsin Steel Workers, 502 F.2d 1309 (7th Cir. 1974); Tuma v. American Can Co., 373 F. Supp. 218 (D.N.J. 1974); Kewin v. Melvendale Bd. of Educ., 65 Mich. App. 472, 237 N.W.2d 514 (1975); Markarian v. Roadway Express, Inc., 56 Mich. App. 43, 223 N.W.2d 356 (1974).

[99]415 U.S. at 53.

[100]*See, e.g.*, Southbridge Plastics Div. v. Rubber Workers Local 759, 403 F. Supp. 1183 (N.D. Miss. 1975); Goodyear Tire & Rubber Co. v. Rubber Workers Local 200, 42 Ohio St. 2d 516, 330 N.E.2d 703 (1975); Bridgeton Educ. Ass'n v. Board of Educ., 132 N.J. Super. 554, 334 A.2d 376 (1975); Board of Higher Educ. v. Professional Staff Congress, 80 Misc. 2d 297, 362 N.Y.S.2d 985 (1975).

[101]403 F. Supp. 1183 (N.D. Miss. 1975).

[102]The conciliation agreement provided, in part, as follows:

> [A]ll recruiting, hiring, training, compensation, overtime, job classifications and assignments, working conditions and privileges of employment shall be maintained and conducted in a manner which does not discriminate on the basis of race, color, sex, religion or national origin in violation of Title VII of the Civil Rights Act of 1964, as amended.
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> . . . .
>
> . . . [N]otwithstanding any provision(s) of any collective bargaining agreement to which it is a party at its Corinth facility, including a contract with the International Union of the United Rubber, Cork, Linoleum and Plastic Workers of America and its Local Union Number 759, [Southbridge] will adhere to the following:
>
> a. No female employee, whether employed at the present time or hired at a future date, will be removed from her job or her shift by a male employee by utilization of the shift preference provisions of any collective bargaining agreement in effect at the Corinth facility.

initiated grievances when several senior males were not given preference in shift assignments within the plant. Southbridge refused to arbitrate, reasoning that if the arbitrator's decision were favorable to the union members, the company would be required to reassign female employees, contrary to Title VII and the EEOC conciliation agreement. The company then sought an injunction "to preclude the union from utilizing the clauses of the collective bargaining agreement upon which it relies in initiating and processing the instant grievances."[103] Citing *Alexander*, the court stated the following:

> The court is of the opinion that *no useful purpose would be served by requiring arbitration of the grievances* filed by the union members. Since the arbitrator should not and could not go beyond the bounds of the collective bargaining agreement in resolving the dispute before him, he or she would be unable to consider the effect of Title VII upon the relative rights of the parties. "[T]he arbitrator has authority to resolve only questions of contractual rights. . . ." Arbitration under these conditions would be futile and pointless.[104]

The decision in *Southbridge* is unfortunate and probably incorrect. It is doubtful that the *Alexander* decision stands for the proposition that federal courts should grant such injunctive relief merely

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> b. In the event that it becomes necessary for [Southbridge] to lay off employees who are in effect at the Corinth facility and said layoff will result in females being laid off if the applicable provisions of the collective bargaining agreement were utilized in a greater percentage than they constitute of the bargaining unit, the following procedure will be utilized:
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> (1) Female employees will be laid off in direct proportion to the percentage which they make up of a bargaining unit covered by a collective bargaining agreement. For example, if in a bargaining unit covered by a collective bargaining agreement which has four hundred (400) members of which three hundred (300) are male and one hundred (100) females who have less plant seniority than the males, [Southbridge] decides to lay off one hundred (100) employees, then since females constitute 25 percent of the bargaining unit, twenty-five (25) females in order of their seniority will be laid off.
>
> (2) In no event will any female employee be laid off by utilization of the foregoing procedure if she would not have been laid off if the applicable contract provisions were utilized. For example, if [Southbridge] were to lay off one hundred (100) employees in accordance with the terms of the applicable collective bargaining agreement and only ten (10) females would be laid off, then only ten (10) females will be laid off.

Id. at 1185-86.

[103] *Id.* at 1185.

[104] *Id.* at 1188 (citations omitted) (emphasis added).

because the court feels that an arbitrator should not and would not consider the effect of Title VII upon the relative rights of the parties. *Alexander* contemplates that the parties may resolve Title VII-type disputes in the grievance and arbitration procedures.[105] In *Southbridge*, the court felt that "no useful purpose would be served by requiring arbitration."[106] Arbitration of the dispute in this case *may* have served no useful purpose, but this is not to assert that arbitration *could not have* served a useful purpose. The arbitrator could well have adopted Howlett's theory[107] that the agreement "incorporates the law" and then rendered a decision consistent with Title VII. In addition, the conciliation agreement would not have precluded such a result. A conciliation agreement "is nothing more than a contractual settlement of a dispute prior to filing of suit, and, as such, is to be analyzed according to the general contract law principles of federal law."[108] Furthermore, the agreement may be more exacting than Title VII by requiring the parties to the agreement to engage in a course of action not otherwise required by Title VII.[109] In *Southbridge*, the union was not a party to the conciliation settlement and was therefore not affected by any "deals" the employer struck with the EEOC. The Company effectively bound itself to two agreements, one with the union, and another with the EEOC. With respect to the rights of the parties under the collective bargaining agreement, the conciliation agreement was a nullity. If, in fact, the seniority provisions of the collective bargaining agreement were in conflict with Title VII, a determination to this effect could have been made independently of the conciliation agreement. Moreover, an arbitrator may well have made this determination under the collective bargaining agreement so as to render a decision consistent with Title VII. The *Southbridge* solution of denying the union access to arbitration encourages employers to attempt to extricate themselves from the unenviable dilemma of defending actions in two forums, a solution arguably neither warranted nor contemplated by *Alexander*.

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[105]415 U.S. at 55.

[106]403 F. Supp. at 1188.

[107]Howlett, *The Arbitrator, the NLRB, and the Courts*, note 29 *supra*. *See* notes 39-44 *supra* and accompanying text.

[108]EEOC v. Mississippi Baptist Hosp., 12 Fair Empl. Prac. Cas. 411, 412 (S.D. Miss. 1976).

[109]*See, e.g.*, Jersey Cent. Power & Light Co. v. Local 327, IBEW, 508 F.2d 687 (3d Cir. 1975), where the conciliation in effect required the company to establish a five-year affirmative action program designed to increase the percentage of minority group and female employees. In addition, it provided for reporting, modification of the maternity leave policies, and certain payments by the company to employees and others for past discriminatory practices. *Id.* at 695.

Bridgeton Education Association v. Board of Education[110] was decided subsequently to *Alexander* and dealt with the issue of arbitral authority to decide statutory issues. In *Bridgeton*, the teachers' association filed grievances when the Board of Education unilaterally changed the requirements that special education teachers would have to satisfy in order to continue receiving extra pay of $400. Following the grievance procedure in the contract, the association processed the grievance through four steps, but the final determination was adverse to the teachers. Rather than proceeding to arbitration, the association filed suit claiming that such a policy change is a working condition which must be negotiated under state law. The Board of Education argued that the elimination of extra compensation was merely a "policy decision," and, as such, the grievance procedure was the proper method for resolving the dispute under New Jersey law; since the association had already chosen the grievance procedure, it was foreclosed from filing suit due to estoppel, laches, and failure to exhaust administrative remedies.[111]

In holding for the teachers, the court identified the issue to be whether the association was foreclosed from instituting the suit because it had previously elected to file a grievance.[112] The court stated that it was "uniquely a court's function to rule on alleged violations of statutes."[113] "The grievance procedure does not and cannot decide if a statute has been violated. That question is for the court, and the fact that an act may constitute a grievance does not foreclose a court from deciding if the same act also violates a statute."[114]

The New Jersey court was correct in stating that the grievance does not and cannot decide if a statute has been violated. Recognizing that this case did not involve a violation of Title VII, the New Jersey court cited Justice Powell's language in *Alexander*: "[T]he distinctively separate nature of . . . contractual and statutory rights is not vitiated merely because both were violated as a result of the same factual occurrence."[115] But, as in *Southbridge*, the grievance procedure could have resolved the dispute and the resolution may well have been consistent with the statute. Arguably, the court had a more narrow alternative available in *Bridgeton*. Pursuant to the policy of the National Labor Relations Board, the court could have deferred to the arbitrator's expertise in resolving the grievance

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[110]132 N.J. Super. 554, 334 A.2d 376 (Super. Ct. 1975).

[111]*Id.* at 557, 334 A.2d at 378.

[112]*Id.*

[113]*Id.*

[114]*Id.*

[115]*Id.* (quoting Alexander v. Gardner-Denver Co., 415 U.S. 36, 50 (1974)).

dispute while still retaining jurisdiction to the Title VII suit. If the arbitral resolution was contrary to, or inconsistent with the statute, the court could have amended or vacated the award. Such an alternative would have accommodated the arbitral forum while at the same time preserving the statutory rights of the parties.

Goodyear Tire & Rubber Co. v. Rubber Workers Local 200,[116] decided subsequently to *Alexander*, involved arbitral authority and Title VII-type issues. Goodyear filed an action in state court seeking to vacate an arbitrator's award granted pursuant to the terms of the collective bargaining agreement. The company and the union were parties to two agreements, a collective bargaining agreement and a pension agreement. The union challenged provisions in each agreement, applying different standards to maternity disability from those applied to other forms of disability caused by illness or injury.[117] The dispute was submitted to arbitration as provided for in the grievance procedure of both agreements and the arbitrator sustained the grievance with regard to the payment of disability benefits under the pension agreement. No case for a denial of disability leave or extension was presented under the collective bargaining agreement. The company argued that the arbitrator had exceeded his powers in that he made an error in law by determining that the EEOC guidelines[118] were federal regulations. The pension agreement in effect at the time of the dispute contained a clause which provided that "the provisions [of the agreement] may be appropriately modified where necessitated by federal or state statute or regulation."[119] The arbitrator held that the guidelines had become a part of the Code of Federal Regulations, and, accordingly, constituted a federal regulation within the meaning of the pension agreement.[120]

The Ohio Supreme Court refused to vacate the award. The court stated that the company was correct in asserting that the EEOC guideline cited was not a federal regulation, but rather an admini-

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[116]42 Ohio St. 2d 516, 330 N.E.2d 703 (1975).

[117]The collective bargaining agreement provided for temporary disability leave for the period of any illness, but limited pregnancy leave to four months after the birth of the child. The pension agreement provided for the payment of disability benefits for a maximum of 52 weeks for all disabilities due to any one pregnancy. *Id.* at 517, 330 N.E.2d at 705.

[118]The specific guideline concerning employment policies relating to pregnancy and childbirth, 29 C.F.R. § 1604.10(b) (1976), essentially provides that disabilities caused or contributed by pregnancy or related conditions must be treated in the same manner as other temporary disabilities for purposes of benefits, privileges, and leave.

[119]Goodyear Tire & Rubber Co. v. Rubber Workers Local 200, 42 Ohio St. 2d at 519, 330 N.E.2d at 706.

[120]*Id.* at 520-21, 330 N.E.2d at 707.

strative determination of the meaning of Title VII promulgated by the EEOC.[121] In addition, the decision of the arbitrator was held to be ambiguous.

> It could mean either that the arbitrator believed the Guideline to be binding, or that he interpreted the term "regulation," as used in the contract, to include an administrative Guideline such as this one, which was published in the Code of Federal Regulations and was an administrative interpretation of a federal statute.[122]

Nevertheless, the court, citing *Enterprise Wheel*, stated that "[a] mere ambiguity in the opinion . . . which permits the inference that the arbitrator may have exceeded his authority, is not a reason for refusing to enforce the award."[123]

It is interesting to contrast the decision by the Ohio Supreme Court with that of the federal court in *Southbridge*. In *Southbridge*, the arbitrator was never afforded the opportunity to resolve the dispute under the collective bargaining agreement. Rather, the federal court ruled that "no useful purpose could be served by requiring arbitration" since the arbitrator could not and should not consider the effect of Title VII on the rights of the parties. Had the facts of *Goodyear* been before the *Southbridge* court, the decision may have gone the other way. The federal court may have reasoned that since the EEOC guidelines are not federal regulations, the arbitrator could not consider the effects of Title VII with respect to the disputed contractual provisions. Concededly, the contract in *Goodyear* made it easier for the arbitrator to render a decision based on the agreement which would be consistent with Title VII. Unlike the contract in *Southbridge*,[124] the *Goodyear* agreement contained an explicit provision which effectively allowed the arbitrator to appropriately modify the agreement where necessitated by federal or state statute or regulation.[125] But again, the arbitrator could have concluded that the contract in *Southbridge* did "incorporate the law," based on a Howlett-type theory, and thereby rendered a decision consistent with Title VII.

V. Conclusion

The main infirmity in applying the law to resolve Title VII-type grievances is neither that arbitrators, as a class, are incompetent,

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[121] *Id.*

[122] *Id.*

[123] *Id.* at 522, 330 N.E.2d at 707.

[124] *See* note 102 *supra*.

[125] 42 Ohio St. 2d at 520, 330 N.E.2d at 706.

nor that the entire discrimination area is so complex that arbitrators could not acquire the necessary expertise to resolve the case consistently with Title VII or other relevant statutes.[126] Rather, the infirmity lies in clothing the arbitrator's decision with a greater degree of finality than that of a federal court, which is the effective result when an individual is precluded from commencing a Title VII action because he first resorted to the arbitral forum. In light of the paramount national policy of eliminating employment discrimination, it is desirable to protect an individual from an erroneous decision by allowing an effective appeal from an arbitral decision when Title VII rights are at issue; such is the state of the law after *Alexander.*

Alexander mandates that the courts grant a statutory remedy *in addition to, and not as a substitute for,* any contractual remedy granted by an arbitrator. As indicated earlier,[127] the courts in *Southbridge* and *Bridgeton* effectively granted statutory relief as a substitute for arbitration. Therefore, the result in the *Goodyear* decision is arguably more consistent with the tenor of *Alexander*; that is, although the arbitrator has the authority to resolve only questions of contractual rights, the arbitrator's decision pursuant to the collective bargaining contract may also afford the parties a solution to an industrial dispute which is consistent with Title VII.

Indeed, there are compelling policy reasons for providing the arbitral forum with the opportunity to resolve Title VII-type grievances, notwithstanding the absence of finality under *Alexander.* While *Alexander* made it clear that an arbitrator's decision does not preclude an employee from subsequently filing a Title VII action in federal court, it nevertheless sanctioned the grievance and arbitration mechanism as a relatively inexpensive and expeditious means for resolving a wide range of disputes, including claims of discriminatory employment practices.[128] This would especially be true when

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[126]There is a tacit assumption throughout the discussion in this Article, and the discussion in *Alexander* with respect to the competence or expertise of labor arbitrators. The assumption is that an arbitrator who lacks expertise in the Title VII area will do better to ignore the legal issues, rather than attempt to decide the issue, hoping to resolve the dispute consistently with Title VII, notwithstanding the lack of expertise; or attempt to educate himself with respect to Title VII and then make the decision, again hoping to resolve the grievance in accordance with the law. Perhaps the main focus should be on the parties that control the arbitration process. The union and employer may in fact not want to settle the legal issue and that is why they are in arbitration, not in a court of law. In cases where the parties are in arbitration because they prefer a settlement rather than employee rights under Title VII, the decision in *Alexander* not to preclude an individual from initiating a suit in federal court subsequent to an arbitral hearing appears all the more correct.

[127]*See* notes 101-15 *supra.*

[128]415 U.S. at 55.

the agreement contains a nondiscrimination provision similar to that of Title VII.[129]

Considering the expense and time necessary to process a Title VII-type grievance, use of the arbitral forum would relieve the EEOC and the federal courts of a large backlog.[130] Initial resort to the arbitral forum would further the use of the arbitral process, while relieving the administrative and judicial machinery of cases which could be settled at the grievance or arbitration level. Having employees submit all grievances under the grievance procedure—a procedure negotiated, maintained, and administered by the union—would also tend to minimize any possible disruptive influences resulting from first resorting to "outsiders" for assistance, while enhancing the status of the union as the exclusive bargaining representative. The arbitral forum also provides a means of satisfying the common desire of both labor and management to avoid the adverse publicity of a Title VII suit.

The arbitration procedure itself may even be of therapeutic value to the individual employee in the broader context of democratic self-government in grievance matters. Both parties in an arbitration have the opportunity to select the individual who may ultimately be the final arbiter of the dispute. By selecting an arbitrator who is acquainted with the industrial setting, the resulting decision will more likely measure up to the expectations of the parties.[131]

In view of the aforementioned advantages of the arbitral forum, it becomes crucial to maintain such a forum as a viable institution

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[129]In Emporium Capwell Co. v. Western Addition Community Organization, 420 U.S. 50 (1975), a post-*Alexander* decision, the Court again voiced its approval of the grievance mechanism for the possible resolution of Title VII claims. The Court stated: "The collective-bargaining agreement involved here prohibited without qualification all manner of invidious discrimination and made any claimed violation a grievable issue. The grievance procedure is directed precisely at determining whether discrimination has occurred." 420 U.S. at 66. In this particular case, that orderly determination could resolve a "pattern or practice" of discrimination. *Id.* at 66-67.

[130]For example, in fiscal year 1974 the EEOC received 56,000 new charges; meanwhile, 78,000 investigations were in process. 9 EEOC ANN. REP. 47 (1974). The total budget for the EEOC during this period was 44.5 million. *Id.* at 29.

[131]When discrimination is at issue, the question arises over how to select the arbitrator and how to conduct the hearing so as to insure that all the facts and issues are presented in a manner which adequately addresses the discrimination issue. A common criticism of arbitration is that the grievant generally has no say in selecting the arbitrator and no effective role in conducting the hearing. *See* Brodie, *Antidiscrimination Clauses and Grievance Processes*, 25 LAB. L.J. 352 (1974); Bloch, *Race Discrimination in Industry and the Grievance Process*, 21 LAB. L.J. 627 (1970). The argument that it may be unrealistic to trust the arbitration process to resolve Title VII disputes when the process is written, designed, and controlled by the parties may have much

for the resolution of civil rights disputes. The opposite tendency could well result by an overextension of *Alexander*. The mere possibility that an arbitral award will not be in accord with the mandates of Title VII, either because the arbitrator fails to "look to the law for help" in resolving a contractual dispute, or because the arbitrator incorporates an incorrect interpretation of Title VII in his award, should not preclude access to the arbitral forum. Courts should not grant statutory relief as a substitute for contractual remedies. To do so would effectively displace an individual's contract rights with those of a statute, a result not warranted or even contemplated by *Alexander*.

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merit, especially if the individual is simultaneously charging the union and the employer with acts of discrimination. *See, e.g.*, Robinson v. Lorillard Corp., 444 F.2d 791 (4th Cir. 1971); Local 189, United Papermakers v. United States, 416 F.2d 980 (5th Cir. 1969).

A partial solution to the potential conflict-of-interest problem is to allow grievants to appear with their own counsel at the arbitration hearing. However, in absence of clear evidence that the grievant will not be fairly represented by the union, he or she will generally not be permitted to retain outside counsel to prosecute a claim. In addition, outside civil-rights or other interest groups will not be allowed any third-party intervention rights to submit grievances, or to represent employees in arbitration who are covered by a contract and represented by a union. Even if the individual is provided the option to be represented by his or her own attorney in an arbitration hearing, this option may be of doubtful effectiveness if the individual is urging an interpretation of the collective bargaining agreement which differs from that of the parties who negotiated the contract, or if the individual is attacking the provisions of the agreement as being "unjust" or "improvidently negotiated." In addition, Meltzer has noted that the grievant who exercises that option would in effect be expressing his distruct of union representation whose good will might be important in preparing the case. Meltzer, *Labor Arbitration and Overlapping and Conflicting Remedies for Employment Discrimination*, 39 U. CHI. L. REV. 30, 45 (1971).

Note

Federal Clean Air Policy: Its Uncertain Foundations

The Clean Air Act Amendments of 1970[1] proposed a significant change in the federal policy of air pollution control. The 1970 Amendments were unique in that, for the first time, protection of the public health and welfare would be the sole consideration in defining federal air pollution regulatory standards.[2] The strength of any regulatory policy, however, rests in the accumulated knowledge which supports the application of the policy's legal requirements under sanction of law.[3] Due to the inherent limitations on the ability of scientists to quantify the adverse health and welfare effects from *all* levels of air pollution exposure, the present federal air pollution control policy lacks the knowledge base necessary to set true health- and welfare-protective standards.

The purpose of this Note is to review the uncertain foundations of the present federal air pollution regulatory program. Such a review will permit an appraisal of the wisdom in selecting a clean air policy whose sole objective is to set air pollution control standards at levels thought to be protective of the public health and welfare, and will permit an evaluation of the impact such a policy will have on the future health and welfare of our nation.

I. 1955-1965: Increasing Federal Involvement—The Early Foundations

The Air Pollution Control Act of 1955[4] was the first legislation to establish an identifiable federal clean air policy. Congress acted in "recognition of the dangers to the public health and welfare . . . from air pollution," but the declared federal policy was "to support

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[1]42 U.S.C. §§ 1857a-1858 (1970) (amending the Air Quality Act of 1967, Pub. L. No. 90-148, 81 Stat. 485 (1967)). The 1970 Amendments are at the heart of the present federal clean air policy. The Clean Air Act, which was formerly classified to 42 U.S.C. §§ 1857-1858, has been transferred and will now be classified to 42 U.S.C. §§ 7401 *et seq.*, pursuant to the Clean Air Act Amendments of 1977, Pub. L. No. 95-95, 91 Stat. 685. All citations appearing herein to the Clean Air Act as amended prior to 1977, however, will be to the former classification.

[2]116 Cong. Rec. 32901-02 (1970) (remarks of Senator Muskie): "The first responsibility of Congress . . . [now] is to establish what the public interest requires to protect the health of persons."

[3]For an excellent discussion of the fallacy of basing environmental policies on insufficient knowledge, see B. Ackerman, The Uncertain Search for Environmental Quality (1974).

[4]Air Pollution Control Act of 1955, Pub. L. No. 84-159, 69 Stat. 322 (1955) (repealed 1963).

and aid *technical* research to devise and develop methods of abating . . . [air] pollution."[5] The primary federal emphasis was not given to researching the health and welfare effects of air pollution exposure. Congress perceived air pollution control to be an engineering problem of state and local concern; federal funds were to be provided primarily to support the development of the control technologies necessary to attack air pollution at its source through emissions limitating devises.[6]

By 1959, progress was being made in technological control research, but "basic knowledge of the effects of air pollutants on humans was needed in many areas."[7] A bill introduced in the House of Representatives that year called for a federal policy shift from technological research support to regulation for the first time.[8] The bill proposed that federally imposed limitations be set on the amount of air pollutants that could be emitted in automobile exhaust. It was proposed that the Surgeon General of the Public Health Service be given the responsibility of establishing limitations on the emission of automobile air pollutants for which sufficient scientific information was then available to permit a judgment as to their adverse effects upon human health. Congress was unwilling, in 1959, to adopt any form of federal regulatory powers for the control of air pollution, but as a compromise measure, the Surgeon General was directed to conduct a "thorough study" of automobile exhaust pollutants to establish what levels of emissions limitation would be required to protect human health.[9] The paucity of available health effects evidence was demonstrated in 1962, when the Surgeon General reported that he was unable to establish the existence of any scientific evidence confirming direct causal relationships between adverse human health effects and automobile exhaust air pollution.[10] He was only able to report the existence of ample scientific data verifying a generally recognized *link* between automobile exhaust and human disease.[11]

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[5]*Id.* § 1 (emphasis added).

[6]*See* J. BONINE, THE EVOLUTION OF TECHNOLOGY-FORCING IN THE CLEAN AIR ACT (ENVIR. REP. (BNA) Monograph No. 21, 1975).

[7]105 CONG. REC. 17585 (1959) (remarks of Representative Roberts on reviewing the 1959 level of federal funding for air pollution research). The effects of air pollutants on human health were not totally without attention. Many research projects were already attempting to study the possible health effects of air pollution, including studies supported through contracts and grants from numerous federal agencies. *See id.*

[8]H.R. 1346, 86th Cong., 1st Sess., 105 CONG. REC. 57 (1959).

[9]Act of June 8, 1969, Pub. L. No. 86-493, 74 Stat. 162 (1960) (amended 1963).

[10]H.R. DOC. No. 489, 87th Cong., 2d Sess. 189 (1962).

[11]*Id.* at 54.

The following year, the Clean Air Act of 1963[12] directed that more attention be given to the study of the possible health and welfare effects of the known air pollutants. The Secretary of Health, Education, and Welfare was directed to conduct his own health effects research and also to survey the results of other scientific studies relating air pollution to adverse health and welfare effects.[13] For those air pollutants that were found to produce harmful effects, the Secretary was to compile and publish air quality criteria documents which would accurately reflect the latest scientific knowledge as to the nature and extent of the harm to be anticipated.[14] Despite the increased interest, the air quality criteria documents were not going to assume a significant role in federal clean air policy, for in 1963, they were to be published only for "informational purposes."[15] Two years later the Secretary had yet to publish the first air quality criteria document.

In 1965, federal clean air policy made the initial shift from technological research support to regulation. Congress recognized that although automotive smog was not the only source of air pollution, it was a problem that was occurring with increasing frequency and severity in urban areas and therefore required immediate legislative attention.[16] The Motor Vehicle Air Pollution Control Act[17] proposed that national emission limitations be set for the major automobile exhaust pollutants.[18]

The proposed legislation differed from the first failing efforts to set automobile emission limitations in 1959. The latter sought to establish limitations at levels that would have been "safe from the standpoint of human health,"[19] and Congress had called for research

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[12]Clean Air Act of 1963, Pub. L. No. 88-206, 77 Stat. 392 (1963) (amended 1965).

[13]*Id.* § 3(c)(1).

[14]*Id.* § 3(c)(2).

[15]*Id.* The questionable importance of even asking for a compilation of the existing health effects data was illustrated by Senator Mansfield's comments on the status of health effects research as of 1963: "A great deal of basic research is needed in air pollution control. To show how far they have to go, scientists are nowhere near agreement on which pollutants are harmful to the human body. . . ." 109 CONG. REC. 18764 (1963).

[16]Motor Vehicle Air Pollution Control Act, Pub. L. No. 89-272, § 202(a), 79 Stat. 992 (1965).

[17]Motor Vehicle Air Pollution Control Act, Pub. L. No. 89-272, 79 Stat. 992 (1965).

[18]*Id.* § 202. Emission limitations, which would regulate the amount of pollution a source may emit over a specified time period, were to be established for the automobile exhaust pollutants: carbon monoxide, hydrocarbons, and oxides of nitrogen. H.R. REP. NO. 899, 89th Cong., 1st Sess., *reprinted in* [1965] U.S. CODE CONG. & AD. NEWS 3611.

[19]*See* note 8 *supra* and accompanying text.

to substantiate such health-dictated levels in 1960.[20] However, the establishment of health-dictated emissions limitations would have been a difficult task in the absence of scientific evidence confirming direct causal relationships between air pollution and adverse human health effects.[21] In 1965, Congress directed the Secretary of Health, Education, and Welfare to establish the first national automobile emission limitations based solely upon considerations of what would be technologically and economically feasible.[22]

During House discussion of the proposed legislation, Representative Lindsay warned that air pollution emission limitations dictated soley by the currently available products of technological research would not assure the protection of the public health.[23] He introduced an amendment to the Senate version of the Motor Vehicle Air Pollution Control Act to increase the federal role in scientific health effects research by directing the Surgeon General to study and report to Congress the effect of air pollution from *all* sources on the public health.[24] In pleading for support of his amendment, Representative Lindsay reviewed the status of the scientific health effects evidence as of 1965:

> [E]xisting research has yet to establish firm and irrefutable evidence of a *direct causal relationship* between disease and air pollution.
>
> . . . .
>
> . . . Most researchers would admit that more time and intensified effort is needed before firm or definitive answers can be found.
>
> . . . .
>
> *It may be many years before firm and irrefutable evidence confirms the probability that air pollution is a serious threat to human health.*[25]

Although Representative Lindsay's amendment was not adopted,[26] his warning was significant. "Firm and irrefutable" scientific evidence of the direct causal relationships between adverse health effects and air pollution was many years away. Even if air quality criteria documents had been issued in 1965, they would have

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[20]*See* note 9 *supra* and accompanying text.

[21]*See* note 15 *supra* and accompanying text.

[22]Motor Vehicle Air Pollution Control Act, Pub. L. No. 89-272, § 202(a), 79 Stat. 992 (1965).

[23]111 CONG. REC. 6771 (1965).

[24]H.R. 7065, 89th Cong., 1st Sess., 111 CONG. REC. 6807 (1965).

[25]111 CONG. REC. 6769, 6776 (1965) (emphasis added).

[26]*See* S. 306, 89th Cong., 1st Sess., 111 CONG. REC. 25065-68, 25072 (1965).

reviewed scientific evidence which, at best, only established a generally recognized *link* between air pollution and its probable threat to human health.[27] Yet, just two years later, air quality criteria documents were to be made the cornerstones of a newly emerging federal clean air policy, which would require that air quality criteria documents relate firm and irrefutable evidence of direct causal relationships between air pollution and adverse health and welfare effects as a prerequisite to federal regulatory control of air pollution emissions.

II. 1967-1969: Uniform National Industrial Emissions Standards Quashed—Health- and Welfare-Dictated Goals

A. The Air Quality Act of 1967

In January of 1967, President Johnson delivered a message on pollution to the nation in which he recognized that the growing problem of air pollution was not being mastered under the existing control efforts.[28] The President revealed his intention to send to the Congress the Administration's version of the Air Quality Act of 1967, which would require polluting industries to assume more responsibility in solving the nation's growing air pollution problem.[29]

The Administration's bill proposed a sweeping new role for federal regulatory powers by asking Congress to establish uniform national industrial emission standards.[30] Each major polluting industry involved in interstate commerce would be subjected to legally enforceable limitations on the total amount of pollution it could discharge into the atmosphere.[31] The rationale was clear: By uniformly restricting the total amount of air contaminants that each of the nation's largest industrial polluters would be permitted to emit, a

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[27] *See* H.R. Rep. No. 899, 89th Cong., 1st Sess. 3, *reprinted in* [1965] U.S. Code Cong. & Ad. News 3608.

[28] The President's Message to the Congress Proposing Air Pollution Controls and Measures on Safety, Beautification, and Natural Resources, 3 Weekly Comp. of Pres. Doc. 131 (Jan. 30, 1967). The President stated:

> This situation does not exist because it was inevitable, nor because it cannot be controlled. Air pollution is the inevitable consequence of neglect. It can be controlled when that neglect is no longer tolerated.
>
> It will be controlled when the people of America, through their elected representatives, demand the right to air that they and their children can breathe without fear.

Id. at 132.

[29] *Id.* at 133.

[30] *Id.*

[31] *Id.*

large amount of the nation's air pollution could be eliminated. The proposed legislation was a dramatic departure from previous federal policy in one other important respect. The industrial emissions limitations would be set without consideration of the technological or economic feasibility of compliance.[32] If present technological capabilities were not adequate to meet the federally-established emissions limitations, the responsibility for developing the technologies necessary for compliance would be shifted from the public to the polluter.[33]

The Administration's proposal met with strong opposition from industry, whose objection to any form of federally-imposed emissions limitations had been clearly voiced at the Third National Conference on Air Pollution held in Washington, D.C., in December of 1966.[34] It was there that the basic concepts underlying the Administration's proposal had been first discussed.[35] But if the nation's major polluting industries had any serious fears that the Administration's bill would become the foundation for threatening federal regulatory powers, those fears were allayed ten months later when the Air Quality Act of 1967[36] was signed into law.

Though bearing the name of the Administration's proposal, the final draft of the Air Quality Act of 1967 was a more complex but a less industry-threatening substitute, authored by Senator Muskie, Chairman of the Air and Water Pollution Subcommittee of the Senate Public Works Committee. The Muskie substitute rejected the Administration's proposal for national industrial emissions standards as being too inflexible, and for not providing sufficient alternative approaches to air pollution abatement where different regions of the country varied in industrial concentrations, atmosphere conditions, etc.[37] With the exception of the national

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[32]*See Air Pollution—1967: Hearings on S. 780 Before the Subcomm. on Air and Water Pollution of the Senate Comm. on Public Works*, 90th Cong., 1st Sess., 761 (1967). In discussing the Administration's bill before the Senate, then HEW Secretary Gardner stated that federally imposed emissions standards coupled with severe economic penalties for noncompliance would "undoubtedly provide an attractive economic incentive to the development of control technology and will result in better, cheaper and, most importantly, widely applicable ways of reducing pollution from specific sources." *Id.* at 762.

[33]*Id.* at 762. Since 1955, federal monies had been used to develop pollution control technologies which, it was hoped, polluting sources would use if made available.

[34]U.S. DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE, PROCEEDINGS, THE THIRD NATIONAL CONFERENCE ON AIR POLLUTION 265-66 (1966).

[35]*See id.* at 12-15 (address of HEW Secretary Gardner).

[36]Air Quality Control Act of 1967, Pub. L. No. 90-148, 81 Stat. 485 (1967) (amended 1970).

[37]*See* 1966 CONFERENCE, *supra* note 34, at 597.

automotive exhaust emission limitations adopted in 1965,[38] the nation would not be given a federal clean air policy that would require major air polluters to immediately curb the emission of poisonous air contaminants; instead, the Air Quality Act of 1967 focused upon clean air goals.[39] Since damage to the public health and welfare had been the primary concern with respect to air pollution, as an alternative to nationally imposed emissions limitations it was proposed that "reasonable regulation should be based on an *accurate* measurement of the health and welfare needs" of the public.[40] As the source for determining those needs, attention was directed to the revival of the air quality criteria concept that had been adopted in the Clean Air Act of 1963,[41] but which would suddenly assume a role of "much greater importance" in the Air Quality Act of 1967.[42]

The Secretary of Health, Education, and Welfare was again directed to publish air quality criteria documents detailing what the best available scientific evidence established as the levels of air pollution concentrations that were harmful to the public's health and welfare.[43] However, these documents were no longer to serve as mere sources of information but were now to serve as the basis for the implementation of state air pollution control programs. The desired flexibility in the federal air pollution abatement effort was accomplished by allowing each state to *voluntarily* implement their own programs of air pollution control in accordance with their individual needs. State programs were to require only that individual polluting sources reduce their pollution emissions enough so that the aggregate of emissions from all sources would result in ambient air pollution concentrations below the levels that the air quality criteria documents verified as being safe for the public health and welfare.[44]

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[38]*See* note 16 *supra* and accompanying text.

[39]*See generally* 1966 CONFERENCE, *supra* note 34, at 597-600.

[40]S. REP. No. 403, 90th Cong., 1st Sess. 10 (1967).

[41]*See* note 12 *supra* and accompanying text.

[42]H.R. REP. No. 728, 90th Cong., 1st Sess. 16, *reprinted in* [1967] U.S. CODE CONG. & AD. NEWS 1952.

[43]Air Quality Act of 1967, Pub. L. No. 90-148, § 108, 81 Stat. 485 (1967) (amended 1970).

[44]1967 S. REP., *supra* note 40, at 44-45. The Air Quality Act of 1967 asked the states to voluntarily adopt air quality standards, which would be the ambient air concentrations of individual pollutants that would be allowable in the atmosphere from *all* sources, based upon the scientific health effects data to be published in the federal air quality criteria documents. Pub. L. No. 90-148, § 108, 81 Stat. 485 (1967). The air quality standards by themselves would be meaningless numbers, however. The states were encouraged to adopt control plans, called "implementation plans," which would translate the requirements of the air quality standards into emissions limitations for individual polluting sources. To accomplish this end the Act proposed that the state control plans reduce complexities such as individual source emission rates, atmospheric

However, the Air Quality Act of 1967 did not suggest that these voluntary state control programs immediately require that individual pollution emissions be reduced to comply with the allowable concentration levels; it only established the air quality criteria documents' findings as the ultimate goals of air pollution control.[45] In addition, there was not going to be a shift of responsibility from the public to the polluter for the development of abatement technology. States were allowed to take into consideration the technological and economic feasibility of any emissions controls they would require of an individual polluting source.[46]

Although in introducing his bill on the floor of the Senate Senator Muskie stated that "no one . . . [had] the right to use the atmosphere as a garbage dump,"[47] the Air Quality Act of 1967, in effect, licensed industry's right to pollute the atmosphere. By defining goals of air pollution control instead of imposing strict uniform national industrial emission limitations, the atmosphere would be polluted to levels of contamination that were dictated by the current limits of science's ability to determine direct causal relationships between air pollution exposure and adverse health and welfare effects.

The exact nature of the burden placed upon the nation's scientists, and the breathing public, became clearer when the House Commerce Committee indicated that for air quality criteria documents to be credible, they would now have to be "based upon the most careful studies and analysis" in order to justify relying upon them in developing effective and reasonable abatement programs.[48] Representatives from Health, Education, and Welfare testified in Senate hearings that they would neither make a finding nor establish an air quality criteria document unless the evidence was "considerable" or "substantial," and that any controls should be "related to *measurable* and *demonstrable* effects on public health and welfare."[49]

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chemistry, meterology, topography, projections of increased urbanization, industrialization, and population into mathematical models. Such models were then to be used to determine the degree of emission control necessary for each of the individual polluting sources to bring the overall air quality to levels below those established by state air quality standards. *Id.*

[45]Thus, as abatement technology advanced, more restrictive emissions limitations were to be implemented until the air quality standards were reached. 1967 S. REP., *supra* note 40, at 30.

[46]*Id.* at 3, 38.

[47]113 CONG. REC. 19171 (1967).

[48]H.R. REP. No. 728, 90th Cong., 1st Sess. 14, *reprinted in* [1967] U.S. CODE CONG. & AD. NEWS 1949.

[49]*Air Pollution—1967: Hearings Before the Subcomm. on Air and Water Pollution of the Senate Comm. on Public Works*, 90th Cong., 1st Sess., 2517, 2524 (1967).

However, as indicated by extensive Congressional hearings,[50] the increased importance and demands upon air quality criteria documents had not been matched by a concomitant advance in pollution health effects knowledge that was adequate enough to support the complex clean air policy proposed. Dr. Barry Commoner, then the Director of the Center for the Biology of Natural Systems, Washington University, in testimony before the Senate Subcommittee on Air and Water Pollution, summarized the nature of the burden the Air Quality Act of 1967 would place upon health and welfare effects researchers:

> In order to evaluate the biological hazard [of air pollution], we first need to know what substances are emitted into the air in the original effluents, . . . the way in which they interact chemically to produce new pollutants, and, finally, the influence of the resultant chemical mixture on health.
>
> It is evident there is very little detailed information of this sort . . . in the country . . . , [yet] the accuracy of a prediction of the effect of attempting to control any single pollutant will depend entirely on whether we understand the entire complex picture. . . .
>
> The air pollution problem involves a complex network of chemical and biological interactions. . . . [W]e may be fooled into thinking things are going to work out because we have established the best standards we now know.[51]

The Subcommittee on Air and Water Pollution heard additional scientific testimony from expert witnesses who verified that many of the identified pollutants which contaminated the air were known to be highly toxic, even deadly when inhaled in large doses over short periods of time.[52] However, the health and welfare effects from long-term chronic exposure to low concentrations of known toxic substances, the most common form of pollution exposure, were not known.[53] Furthermore, low-level exposure effects would not be known with the scientific exactness necessary to meet the legislative requirements until medical science had had the opportunity to make the long-term medical observations required to give definitive answers.[54]

How much scientific knowledge was needed to serve as the foundation for the establishment of a federal clean air policy whose goal

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[50] *See, e.g., id.* at 2103-28, 2659-81.

[51] *Id.* at 980-81, 985.

[52] *E.g., id.* at 793 (statement of Dr. Ivan L. Bennett, Jr.).

[53] *Id.*

[54] *Id.*

of regulatory control was the protection of the public health and welfare? The Air Quality Act of 1967 had answered the question by enshrining the knowledge-limited air quality criteria document as the cornerstone of new federal air pollution control efforts and thereby establishing the blueprint for future changes in federal clean air policy. Furthermore, because of its dependence on health and welfare effects evidence, it had also become an Act which polluting industries could support, for when federal regulation would require nonprofit-making expenditures by industry, as any air pollution controls would, any form of time delay represents money saved.[55] The Administration's concept of immediate uniform national industrial emission limitations had been quashed and replaced with an alternative that promised to require long and costly scientific investigations and abatement technology developments before strict pollution regulations would become a serious threat to a polluter. From the polluter's perspective, the only real future threat posed by the Air Quality Act of 1967 would be the ability of science to meet the heavy burden of proving measurable and demonstrable health and welfare effects for the lower exposure levels of the known air pollutants, or science's ability to identify the health and welfare effects of, as yet, unknown atmospheric poisons. The real threat to the public would be that medical science would not possess the capabilities necessary to meet those burdens for decades, even if strong probabilities of adverse effects were immediately established.[56]

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[55]*See* J. ESPOSITO, VANISHING AIR (1970), where the following evaluation of the Air Quality Act of 1967 is offered:

> The striking resemblance of the Air Quality Act of 1967 to the impressive body of industrial public relations literature that preceded it makes clear that the Act adopted an approach which industry had endorsed for many years prior to enactment. Although the antecedents of the law can be found in many corporate publications, one pamphlet—*A Rational Approach to Air Pollution Legislation*, published by the Manufacturing Chemists Association (MCA) in 1952—is remarkable for the degree to which it "anticipates" legislation passed fifteen years later.
>
> Point by point, the Air Quality Act of 1967 follows the path spelled out by the MCA pamphlet. Three techniques, each designed to buy precious time cheaply, . . . suggest the several ways by which delay can be achieved:
>
> 1. By straining the public's comparatively meager reserves by shifting the burden of proving adverse health effects from the polluter to the public;
>
> 2. By institutionalizing through the concept of ambient air standards the idea that industry has a right to pollute up to a certain level;
>
> 3. By obfuscating the facts through transformation of what should be political decisions into esoteric scientific jargon.

Id. at 260.

[56]Concerning the need for an intensive research effort to upgrade the scientific

B. 1968-1969 Senate Hearings—The Inadequacies of a Health- and Welfare-Based Policy Revealed

The health and welfare consequences of a federal clean air policy which scaled down air pollution emissions based upon the slow progress of scientific research became even clearer in 1968. The Senate Subcommittee on Air and Water Pollution planned a series of hearings to develop the factors to be considered while establishing air quality criteria documents. A staff report[57] prepared for use by the Subcommittee in July of 1968, just prior to the start of the hearings, anticipated the problems that would be presented. The report was designed to summarize existing evidence on the nature, type, and extent of air pollution health effects, and to present the general principles connected with the establishment of scientific and medical recommendations in the development of air quality criteria.[58] The report's conclusions demonstrated the nature of the health and welfare protection the public could expect from a control policy whose standards were set only upon measurable and demonstrable health effects evidence.

The report's findings verified the expert testimony given before the Subcommittee in 1967.[59] Ample quantitative scientific evidence was found to exist relating acute levels of exposure to air pollution and resultant adverse effects on the public health and welfare; this evidence had been gathered primarily during air pollution episodes[60] when persons with chronic bronchitis, lung cancer, and other respiratory and cardiopulmonary diseases suffered aggravated physiological distress or even death. However, limited knowledge existed of the human health effects for many of the known air con-

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data base upon which air quality goals were to be established, the Senate Committee only stated:

> Because the committee is concerned with both long- and short-term hazards as well as the need for valid scientific data to substantiate the correlation between pollution and health and welfare the Secretary [of HEW] is *urged* to move forward with diligence and perseverance in the area of scientific analysis of health effects.

1967 S. REP., *supra* note 40, at 10 (emphasis added).

[57]STAFF OF SENATE COMM. ON PUBLIC WORKS, 90th CONG. 2d SESS., REPORT ON AIR QUALITY CRITERIA (Comm. Print 1968).

[58]*Id.* at vi.

[59]*See* note 52 *supra* and accompanying text.

[60]1968 STAFF REPORT, *supra* note 57 at 5. A large number of studies had been conducted which correlated high atmospheric concentrations of known pollutants with increased mortality rates. Periods of unusually high concentrations of air pollutants were termed "episodes." During episodes, large numbers of individuals who were particularly susceptible to air pollutants became ill and died. However, episodes are only the dramatic short-term manifestations of a long-term problem. *Id.*

taminants under conditions of chronic exposure—the long-term, lower-level exposure of ten, twenty, or thirty years—which the report found had "persistent and insidious effects on public health, on vegetation, and on materials of all kinds and undoubtedly represent[ed], in the long run, a greater damage and loss to individuals than does the occasional air pollution episode."[61] Chronic exposure effects appear in later life as an increased incidence of diseases, which scientists have suspected may be carcinogenically[62] or mutagenically caused, and which are irreversible in most cases.[63] The staff report stated:

> It is quite clear that protection of public health requires quantitative answers regarding the effects of . . . chronic exposures [without which] there is no assurance that control and abatement established for protection against acute conditions . . . will provide adequate protection of public health and welfare against chronic long-term exposures at less than acute levels.[64]

Furthermore, the report concluded that any suggestion that threshold levels existed, below which no adverse health or welfare effects were present, would be "deceiving" since many effects were not observed because "study techniques are either insensitive or the effects unsuspected."[65] In addition, quantification of adverse health and welfare effects required by the Air Quality Act of 1967 would be further complicated because the chemical composition of the urban atmosphere was largely unknown,[66] and little if anything was known of the interactions between combination of individual pollutants.[67] The health effect of two individual contaminants that interact could be additive, competitive, or even multiplicative factors of their individual effect, yet no clear answers had been defined at that time.[68]

The report further recognized that establishing air quality criteria documents would require that individual pollutants be monitored and identified, but as a result of the complexities of at-

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[61] *Id.* at 11.

[62] Health experts now estimate that as many as 60 to 90% of all cancers are environmentally caused. See Tayor, *Echoes of "Silent Spring,"* TRIAL MAGAZINE, November 1968, at 28.

[63] 1968 STAFF REPORT, *supra* note 57, at v.

[64] *Id.*

[65] *Id.*

[66] *Id.* at 12.

[67] *Id.* at 8.

[68] *Id.*

mospheric chemistry, "individual monitoring and identification of the vast number of contaminants in the atmosphere . . . [were] not presently feasible," and therefore, pollution "indices" would have to be established which would only *represent* the wide variety of solid, liquid, and gaseous substances present in the atmosphere.[69] Sulfur dioxide, for example, which is itself an identifiable and measurable air pollutant, would serve as an index for the host of other air pollutants which result from the combustion of coal and oil.[70] It is important to note that the staff report warned that "indices" may be representing other substances "the physical form and chemical composition of which may separately and in combination be of greater relevance to clinical research than expression of their atmospheric concentrations as single [proxy] contaminants."[71] However, due to the lack of adequate scientific knowledge, the pollution "indices" which would be selected to provide a basis for evaluating health and welfare effects of all atmospheric pollution would be limited to those individual contaminants which scientists were able to identify and monitor.

The expert testimony presented before the Senate Subcommittee on Air and Water Pollution in 1968 and 1969 verified the shortcomings of the data base that was to support the emerging federal clean air policy; the best scientific evidence available comprised a totally inadequate data base for the type of scientific conclusions that one would expect the proposed policy to rest upon.[72] Dr. Raymond Slavin, then Assistant Professor of Internal Medicine at St. Louis University, testified concerning the inherent difficulties health effects researchers would face in overcoming the deficiencies the staff report had uncovered:

> It will take long, slow, careful, costly investigation to determine the effects of each pollutant separately and in various combinations—*and meanwhile the mixture we are actually breathing will have changed again.* . . . [C]ontrolling only

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[69] *Id.* at 12.

[70] *Id.*

[71] *Id.* at 13.

[72] *E.g., Air Pollution—1968: Hearings on Air Quality Criteria Before the Subcomm. on Air and Water Pollution of the Senate Comm. on Public Works*, 90th Cong., 2d Sess., at 718 (1968) (statement of Dr. Eric Cassell). Dr. Cassell, Mount Sinai School of Medicine, testified that due to the inherent inabilities of science to quantify low-level adverse health effects, air quality criteria were the wrong goals of air pollution control. Instead, air pollution emissions should be controlled "to the greatest extent feasible employing maximum technological capabilities." *Id. See also* Cassell, *The Health Effects of Air Pollution and Their Implications for Control*, in 33 LAW AND CONTEMPORARY PROBLEMS: AIR POLLUTION CONTROL 197 (1968).

> those pollutants which can be clearly shown to have an effect on health by themselves, means simply not to act against a larger proportion of pollutants because that kind of cause and effect relationship has not been, and perhaps cannot be established.[73]

A great responsibility was therefore placed upon the scientist, and the import of the Air Quality Act of 1967 was clear. Air quality criteria documents could only be issued which would adequately support a clean air policy that attempted to control the gross and obvious air pollution exposures, and control objectives could only be set in terms of a percentage reduction in the ambient air concentrations of identifiable and monitorable pollutants. Polluting industries would not be faced with strict air pollution control regulations of the kind necessary to control the chronic low-level exposures to the known air pollutants or of the kind necessary to control the potential multitude of unidentified atmospheric poisons until scientists could overcome the nearly insurmountable task of quantifying adverse health and welfare effects. Furthermore, even gross and obvious levels of air pollution would not be abated under the Air Quality Act of 1967 if the states found the necessary controls to be economically or technologically infeasible.[74]

The controversy over the adequacy of the data base supporting the emerging federal clean air policy[75] overshadowed the bill which would be described as "perhaps the most significant domestic regulation of the decade."[76] It would firmly establish federal air pollution controls upon a scientific data base that was inadequate to provide sufficient assurances for the protection it would claim to afford the American public.

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[73] *Air Pollution—1969: Hearings Before the Subcomm. on Air and Water Pollution of the Senate Comm. on Public Works*, 91st Cong., 1st Sess. 45 (1969) (statement of Raymond Slavin) (emphasis added).

[74] *See* note 46 *supra* and accompanying text.

[75] In January of 1969, the National Air Pollution Control Administration of the Department of Health, Education, and Welfare announced the issuance of air quality criteria documents for the particulate matter and sulfer oxides indices. Air Quality Criteria for Particulate Matter (NAPCA Publication No. AP-49), Air Quality Criteria for Sulfur Oxides (NAPCA Publication No. AP-50), 34 Fed. Reg. 1988 (1969). In March of 1970, air quality criteria documents were announced for carbon monoxide, photochemical oxidants, and hydrocarbons. Air Quality Criteria for Carbon Monoxide (NAPCA Publication No. AP-62), Air Quality Criteria for Photochemical Oxidants (NAPCA Publication No. AP-63), Air Quality Criteria for Hydrocarbons (NAPCA Publication No. AP-64), 35 Fed. Reg. 4768 (1970).

[76] 116 CONG. REC. 42381, 42394 (1970).

III. 1970: Uniform National Ambient Air Quality Standards—Health- and Welfare-Dictated Controls

A. The Clean Air Act Amendments of 1970

As the decade grew to a close, apart from the controversy over the adequacy of the air quality criteria documents, Congress grew impatient with the lack of progress of the voluntary state control programs anticipated under the Air Quality Act of 1967.[77] It was also becoming readily apparent that merely providing federal funds to support research for the development of methods of abatement and control would not solve the technological problems of air contamination alone, and solutions were not being readily provided through voluntary industry contributions.[78]

The Clean Air Act Amendments of 1970[79] were enacted "to speed up, expand, and intensify the war against air pollution."[80] To accomplish this end, the 1970 Amendments proposed the adoption of new federal regulatory powers that would make mandatory, and set deadlines for, the voluntary control program outlined for the states by the Air Quality Act of 1967. The Administrator of the newly formed Environmental Protection Agency (EPA)[81] was to establish uniform national ambient air quality standards that would prescribe the maximum atmospheric concentrations of air pollutants allowable to insure the protection of the public health and welfare.[82] Each state would then be required to promulgate its own air pollution control plan—or be subjected to a federally promulgated and enforced plan—dictating the reduction in emissions required by each individual pollutant source to bring the aggregate pollutant concentrations below the federally imposed air quality standards.[83]

More significantly, the new national air quality standards were to be based solely upon what could be scientifically demonstrated as necessary to protect the public health and welfare.[84] National air

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[77]*See, e.g., Air Pollution—1969: Hearings on Problems and Programs Associated with the Control of Air Pollution Before the Subcomm. on Air and Water Pollution of the Senate Comm. on Public Works*, 91st Cong., 1st Sess. at 10 (1969).

[78]116 Cong. Rec. 32900-01 (1970) (remarks of Senator Muskie).

[79]42 U.S.C. §§ 1857a-1858 (1970) (amending the Air Quality Act of 1967, Pub. L. No. 90-148, 81 Stat. 485 (1967)).

[80]H.R. Rep. No. 1146, 91st Cong., 2d Sess. 1, *reprinted in* [1970] U.S. Code Cong. & Ad. News 5356.

[81]Reorg. Plan No. 3 of 1970, 3 C.F.R. 1072 (1966-1970 Compilation), *reprinted in* 5 U.S.C. app., at 609 (1970) *and in* 84 Stat. 2086 (1970). This new executive department combined the environmental departments of 15 different federal agencies.

[82]Clean Air Act Amendments of 1970, § 109, 42 U.S.C. § 1857c-4 (1970), *See* note 44 *supra* and accompanying text.

[83]Clean Air Act Amendments of 1970, § 110, 42 U.S.C. § 1857c-5 (1970).

[84]*See* note 2 *supra.*

quality standards and state control plans were to be established and enforced without consideration of technological or economic feasibility.[85] Thus, the new regulatory policy was to be "technology-forcing"[86] by requiring the polluting industries to bear the burden of developing new technologies where necessary to comply with federal health- and welfare-dictated controls.[87] However, the heavier burden of quantifying the health and welfare effects of air pollutants, still a prerequisite to regulatory control, remained upon the public.

Within thirty days of the enactment of the 1970 Amendments the EPA Administrator was to prescribe national "primary" and "secondary" air quality standards for each of the air pollutant "indices" specified in the air quality criteria documents that had been issued prior to 1970.[88] Primary standards were to be set at levels "requisite to protect the public health"[89] and secondary standards at levels "requisite to protect the public welfare."[90] Those levels were to be determined solely by relying on the scientific data compiled in the air quality criteria documents. For each air pollutant found to have an adverse effect on the public health or welfare but not yet covered by an existing air quality criteria document, the EPA Administrator was to issue new air quality criteria and uniform air quality standards concurrently.[91] The 1970 Amendments' answer to the controversy over the inadequacy of the existing scientific data base was to provide that any new criteria documents should include data reflecting the results of exposures to air pollutants "in varying quantities."[92] "[T]o the extent practicable" the new criteria documents were to also include information on the "variable factors" which by themselves or in combination with other factors might alter the effect of a pollutant on health or welfare.[93] However, this language still clearly indicated that any new air quality criteria documents were only expected to reflect the current abilities—or inabilities—of science to quantify the adverse health and welfare effects.[94] Therefore, these provisions did not even begin to solve the

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[85]116 CONG. REC. 32900-01 (1970) (remarks of Senator Muskie).

[86]*See* BONINE, *supra* note 6.

[87]116 CONG. REC. 32900-01 (1970) (remarks of Senator Muskie).

[88]Clean Air Act Amendments of 1970, § 109(a)(1)(A), 42 U.S.C. § 1857c-4(A)(1)(A) (1970). *See* note 43 *supra.*

[89]Clean Air Act Amendments of 1970, § 109(b)(1), 42 U.S.C. § 1857c-4(b)(1) (1970).

[90]*Id.* § 109(b)(2), 42 U.S.C. § 1857c-4(b)(2) (1970).

[91]*Id.* § 108(a)(1), 42 U.S.C. § 1857c-3(a)(1) (1970).

[92]*Id.* § 108(a)(2), 42 U.S.C. § 1857c-3(a)(2) (1970).

[93]*Id.* § 108(a)(2)(A), (B), 42 U.S.C. § 1857c-3(a)(2)(A), (B), (1970).

[94]*Id.* § 108(a)(2), 42 U.S.C. § 1857c-3(a)(2) (1970). The Clean Air Act Amendments of

problems raised in the Senate hearings the year before.[95]

Section 103 of the 1970 Amendments did call for an accelerated health and welfare effects research effort with special attention to be given to both the long- and short-term effects of exposure to air pollution.[96] However, even massive federal research support would not change the nature of the difficult and complex task of quanitifying those effects. Furthermore, although calling for intensified health effects research, the 1970 Amendments failed to provide for a regular review and update of the air quality criteria documents that had been issued prior to 1970. The EPA Administrator was only *urged* to review "from time to time" and to update "as appropriate" those criteria documents issued after the enactment of the 1970 Amendments.[97] Thus, there were not even assurances that the air quality criteria documents would constantly reflect the most recent health effects data. At the EPA Administrator's discretion the air quality criteria documents initially adopted could remain the basis of the federal and state regulatory programs indefinitely.

Other language and provisions of the 1970 Amendments also suggested that the federal clean air policy defined in 1970 focused its attention on short-term pollution abatement goals defined in

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1970 also provided several other specific control measures for the direct reduction of specific pollutants not covered by air quality criteria documents. The EPA Administrator had direct authority to establish and impose emissions limitations for any air pollutants that in his judgment are "hazardous"—hazardous pollutants are defined as those which "may cause, or contribute to, an increase in mortality or an increase in serious irreversible or incapacitating reversible illness." *Id.* § 112(a)(1), 42 U.S.C. § 1857c-7(a)(1) (1970). *All* pollutants from major new sources of potential air pollution are subject to control under section 111. *Id.* § 111, 42 U.S.C. § 1857c-6 (1970). The EPA Administrator is allowed to establish "standards of performance"—emission limitations—for new pollution sources which "significantly" contribute to air pollution or contribute to the "endangerment" of public health or welfare. *Id.* This section potentially would bring all of the emissions from *new* sources under federal control, regardless of their recognition in other control provisions of the 1970 Amendments.

However, all of these provisions share the same catastrophic flaw as pollution controls based upon air quality criteria documents; the reduction of air pollutants is still tied to the ability—or inability—of science to identify, monitor, and demonstrate direct causal relationships between exposures and adverse health effects. For a discussion of the effectiveness of these specific control provisions, see Jorling, *The Federal Law of Air Pollution Control*, in FEDERAL ENVIRONMENTAL LAW 1058, 1103-1107, 1086-1087 (1974).

[95] *See* notes 72-73 *supra* and accompanying text.

[96] Clean Air Act Amendments of 1970, § 103(a), 42 U.S.C. § 1857(a) (1970).

[97] *Id.* § 108(c), 42 U.S.C. § 1857c-3(c) (1970). By December 31, 1980, and at 5-year intervals thereafter, the Administrator now *must* review and revise, as necessary, the air quality criteria documents and ambient air quality standards. The Administrator is also to appoint a new and independent scientific review committee to recommend the needed reviews and revisions. Clean Air Act Amendments of 1977, Pub. L. No. 95-95, § 106, 91 Stat. 691 (to be codified at 42 U.S.C. § 7409).

terms of the currently available knowledge-limited air quality criteria documents. The 1970 Amendments were significantly concerned with the expedition of specific federal air pollution controls. The House report stated: "[I]t is urgent that Congress adopt new clean air legislation which will make possible the more expeditious imposition of specific emission standards . . . and the effective enforcement of such standards by both State and Federal agencies."[98] Thus, from a regulatory point of view it would have been desirable to set aside the controversy over the knowledge-limited data base of the proposed regulations, to establish air pollution exposure levels below which there were no measurable or demonstrable adverse health and welfare effects, and then to establish air quality standards at those levels in the name of protecting the public health and welfare. It would then have been possible to present the polluting industries with a regulatory package of emissions limitations that would remain constant for the foreseeable future. This course of action would certainly encourage the highest probability of effective enforcement, while at the same time leading the public to believe that their health and welfare were fully protected.

The 1970 Amendments have, in effect, accomplished this end by defining an adverse health effect in terms of the scientific limitations of demonstrating a direct causal relationship between disease and exposure to an air contaminant. The Senate committee, where the concept first originated, described the primary air quality standard as follows:

> Ambient air quality is sufficient to protect the health of . . . persons whenever there is an absence of adverse effect on the health of a statistically related sample of persons in sensitive groups from exposure to the ambient air. An ambient air quality standard, therefore, should be the maximum permissible ambient air level of an air pollution agent or class of agents . . . which will protect the health of any group of the population.[99]

Thus, the national primary air quality standard was defined in such a way as to suggest that there were threshold exposure levels below which there were no adverse health effects,[100] when, in fact, air quality standards could only be set at levels below which health researchers had been incapable of quantifying direct causal relation-

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[98]H.R. REP. No. 1146, 91st Cong., 2d Sess 5, *reprinted in* [1970] U.S. CODE CONG. & AD. NEWS 5360.

[99]S. REP. No. 1196, 91st Cong., 2d Sess. 10 (1970) (emphasis added).

[100]*See* note 65 *supra* and accompanying text.

ships between adverse health and welfare effects and exposures to individual air pollutants.

This distortion of the danger air pollution posed to the nation's health was strengthened by the statutory directive requiring the EPA Administrator to apply an "adequate margin of safety" in establishing the primary air quality standard.[101] The legislative purpose of this mandate was to require the resolution of any doubts created by conflicting or ambiguous scientific evidence in favor of protection of the public health. However, when the primary standards would be based upon knowledge-limited air quality criteria documents,[102] what purpose could a "margin of safety" serve other than to create the illusion that the public health would be fully protected? The answer was provided three years later when the first, and to date only, major review of the scientific data supporting the present federal clean air policy was conducted.

B. The National Academy of Sciences Review

In the three years following the enactment of the Clean Air Act Amendments of 1970, many challenges were made, particularly by the polluting industries, concerning the adequacy of the air quality criteria documents used to justify the national air quality standards being imposed on polluting sources via state control plans.[103] The argument was not that the air quality standards were too lenient, but due to the lack of adequate data to support them, they were now subject to complaints of being too strict. In August of 1973, the Senate Committee on Public Works entered into a contract with the National Academy of Sciences[104] for an evaluation and review of the

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[101]Clean Air Act Amendments of 1970, § 109(b)(1), 42 U.S.C. § 1857c-4(b)(1) (1970). The secondary air quality standard, the purpose of which was to protect the public welfare, was defined as being protective against any effects on soils, waters, crops, vegetation, man-made materials, animals, wildlife, weather, visibility, and climate, damage to or deterioration of property, and hazards to transportation, as well as protective against the effects upon economic values and personal comfort and well-being. *Id.* § 302(h), 42 U.S.C. § 1857h(h) (1970). The 1970 Amendments did not intend these standards to include a "margin of safety." *Id.* § 109(b)(2), 42 U.S.C. § 1857c-4(b)(2) (1970).

[102]Primary and secondary air quality standards were promulgated in April of 1971. 40 C.F.R. § 50 (1970). The only new air quality criteria document issued under the 1970 Amendments was for nitrogen oxides. *Id.* There have been no other air quality criteria documents or air quality standards promulgated since 1971.

[103]*See, e.g.*, [1971] 2 ENVIR. REP. (BNA) 249.

[104]The National Academy of Sciences, under its Congressional charter, is called upon to act as the official yet independent advisor to the federal government in any matter of science and technology. This provision accounts for the close ties that have existed between the Academy and the government, although the Academy is not a governmental agency and its activities are not limited to those on behalf of the government.

current scientific data on the health effects of the major air pollutants.[105] Specifically, the contract provided only for the review of data available on the pollution indices for which air quality criteria documents had already been issued.[106]

In partial fulfillment of the contract, the Academy forwarded to the Senate Committee on Public Works a transcript and executive summary of a conference which had been held by the Academy in 1973 for the purpose of gathering the current health effects research data.[107] From the papers and discussions presented at the conference, the executive summary proposed the following tentative conclusion, among others: "Due to the limitations of present [scientific] knowledge, it is impossible at this time to establish an . . . [air quality standard for] any pollutant—other than zero—below which it is certain that no human being will be adversely affected."[108] However, until future health effects researchers could quantify causal relationships between adverse health effects and individual polluants, "no compelling basis" would exist for altering the present air quality standards—those having been set by relying upon data obtained during acute level exposures.[109]

This clear statement of the weaknesses of a health- and welfare-based policy was missing when the Academy released the final

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[105]*See* S. REP. No. 291, 93 Cong., 1st Sess (1973).

[106]*Id.*

[107]NATIONAL ACADEMY OF SCIENCES, CONFERENCE ON HEALTH EFFECTS OF AIR POLLUTION, SUMMARY OF PROCEEDINGS (1973). At the opening of the conference, Senator Muskie addressed himself to the Academy, on behalf of the Subcommittee on Air and Water Pollution, and clearly stated where the burden lies in the present pollution control policy:

> The scientific community . . . has a great responsibility. It is you who must show what levels of air quality are needed to protect the health of people. It is you who must show how your experimental conclusions can be the basis for public policy decisions. You must show who is endangered by dirty air, and what pollutants, in what combinations and concentrations pose the dangers.
>
> As scientists you are the first line of defense for national environmental policy and in air pollution you are the most significant line of defense.

Id. at iii.

[108]*Id.* at 7.

[109]*Id.* at 10. Labeled as a "general comment," the following was also included in the summary statement:

> It will apparently be very difficult to obtain reliable dose-response curves (which relate physiological effects to ambient-air concentrations) for one or more pollutants in question. . . . The conservative view of the Academy in relation to change of the present air quality standards is fostered by emerging data that suggest that observed adverse health effects may arise in considerable part not only from the interactions of bodily tissues with the primary pollutants but with unidentified reaction products generated by complex chemical events in the atmosphere or induced within the lung.

Id.

report of its study in September of 1974,[110] and the evils of its progressive generalizations were apparent. The final report's summary statement concluded that none of the Academy's scientists were satisfied with the current air quality criteria documents' data base; nevertheless, the evidence which had accumulated since the promulgation of the national air quality standards, "*in general*," supported those standards as being protective of the public health and welfare.[111] Furthermore, "*[o]n balance*, the [Academy] found no substantial basis for changing the standards."[112] A comparison of the full report, from which this often-quoted summary was drawn, with the Conference's tentative conclusions, however, indicated that the phrase "on balance" weighed most heavily in favor of the 1970 Amendments' vast regulatory control program, which would have been completely disrupted if air quality standards had been changed by any significant alteration in the air quality criteria documents.

Within the Academy's full report it was conceded that the present air quality standards *were* based upon the assumption that threshold exposure levels existed for air pollutants and that the air quality standards were simply set at a somewhat lower "safety margin" level than the lowest level for which measurable health effects were scientifically identified and quantified.[113] However, the report stated that the concept of threshold exposure levels had "no physiological meaning," since at any concentration in the atmosphere, no matter how small, adverse health effects may occur.[114] As for the "margin of safety" called for in setting the primary air quality standard, the report stated:

> "Margin of safety" is actually a misnomer. . . . [I]t supposedly protects the public from unknown effects that may occur at concentrations within this margin. Since effects may occur at concentrations below the existing standard following improvements in research, the word "safety" can be misleading . . . . *The most serious uncertainty is the lack of information on whether a lower limit exists* . . . .[115]

Despite these revelations concerning the nature of protection being offered by the present regulatory program, the final report sum-

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[110] NATIONAL ACADEMY OF SCIENCES/NATIONAL ACADEMY OF ENGINEERING, AIR QUALITY AND AUTOMOTIVE EMISSION CONTROL, A REPORT BY THE COORDINATING COMMITTEE ON AIR QUALITY STUDIES (1974).

[111] 1 *id.* at 6.

[112] *Id.*

[113] *Id.* at 17. *See* note 65 *supra* and accompanying text.

[114] *Id.*

[115] 2 *id.* at 334-35 (emphasis added).

mary statement provided the Senate Committee on Public Works with the conclusion needed to quash industry criticisms of the 1970 Amendments' air pollution control program. Neither the proponents of the current air quality standards in Congress, nor industry polluters who had already met the present standards had anything to fear from the Academy's report. The issue of the critical lack of scientific data to assure that public health- and welfare-based control standards were truly protective had been generalized away.

IV. Conclusion

The basic premise of the present federal clean air policy is that it is acceptable to permit anyone to dump poisons into the atmosphere until it is shown by measurable and demonstrable evidence that a specific contaminant is causing a specific harm. Only then will its emission into the atmosphere be reduced through federal regulation. However, the one-pollutant-at-a-time approach to air pollution control, which seeks to document the health and welfare effects of each discoverable air pollutant separately, ignores the complexity and continually changing relationships of atmospheric pollution. It is not a single pollutant which produces a single adverse effect, but the entire complex atmospheric mixture that is known to be hazardous to human health and welfare.

Instead of vainly attempting to quantify the adverse effects of this complex mixture—the composition of which is expanding far more rapidly than the scientific knowledge of its health and welfare effects—attention should be directed toward limiting, to the greatest degree possible, the quantity of all of the contaminants entering the mixture. This is precisely the intent of a clean air policy which attempts to uniformly limit the discharges of all air pollutants to the maximum degree at the source. It is the only means of insuring the greatest degree of protection for the public health and welfare.

Uniform national air quality standards and air quality criteria documents are inherently unsatisfactory guidelines for providing the air pollution controls necessary to insure protection of the public health and welfare. To date, the federal regulatory controls imposed by this health- and welfare-dictated policy have only been able to insure protection against exposures to acute levels of certain identifiable and monitorable air pollutant indices. This is because, to date, scientific evidence exists which only provides the requisite measurable and demonstrable health and welfare effects evidence for acute levels of exposure for a handful of pollutant indices. However, regulatory controls will be adequate to fully protect the

public only when provisions are made for protection against chronic low-level exposures to the known air pollutant indices, as well as to the potentially vast numbers of, as yet, unknown atmospheric poisons. Under the present federal policy, the controls necessary to provide further reduction of air pollutant emissions are restricted by the long, slow, and costly progress of the scientific research that will be necessary for, but perhaps inherently incapable of, quantifying adverse health and welfare effects. But until science is able to quantify all of the existing probabilities of air pollution's human dangers, or as long as measurable and demonstrable health and welfare effects evidence is required as a prerequisite to further reductions in air pollution emissions, this nation will be continually misled into believing that the present federal regulatory effort is fully protective against all of the dangers of atmospheric pollution.

CLIFFORD W. BROWNING

The Indiana Environmental Protection Agencies: A Survey and Critique

Since the inception of the environmental movement in the late 1960's, environmental law has undergone an expansion roughly paralleling the expansion of labor law in the 1930's. The resulting legislative explosion has reached all levels of government—federal, state, and local—giving rise to concurrent and sometimes conflicting regulation.

The advent of the Environmental Protection Agency (EPA) and its various enabling statutes[1] provided the states with regulatory models for their own environmental protection efforts. However, the concept of an efficient nationwide pollution abatement program demanded a maximization of state-federal cooperation. The most favorable alternative lay in persuading the individual states to initiate their own enforcement programs under federal guidelines without offending the bounds of the tenth amendment.[2]

This goal became a reality under the strategies of the Clean Air Act Amendments of 1970[3] and the Federal Water Pollution Control Act Amendments of 1972,[4] which authorized the EPA to set pollution limitations sufficient to protect the public health and welfare[5] and to establish a federal environmental enforcement or permit system in each state pursuant to those standards.[6] Each state was encouraged to draft a state regulatory scheme which would uphold the federal standards, taking into account special state problem areas.[7] Upon the EPA's approval of this state implementation plan,[8] the state's pollution abatement system would operate in lieu of the federal program, but would remain partially funded by the EPA.[9]

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[1]For a brief history of recent federal environmental legislation, see 1 A. REITZE, ENVIRONMENTAL LAW three-27, -30 to -32, four-34 to -35 (2d ed. 1972).

[2]U.S. CONST. amend. X.

[3]42 U.S.C. §§ 1857a-1858 (1970). The Clean Air Act, which was formerly classified to 42 U.S.C. §§ 1957-1858, has been transferred and will now be classified to 42 U.S.C. §§ 7401 *et seq.*, pursuant to the Clean Air Act Amendments of 1977, Pub. L. No. 95-95, 91 Stat. 685. All citations appearing herein to the Clean Air Act as amended prior to 1977, however, will be to the former classification.

[4]33 U.S.C. §§ 1251-1376 (Supp. V 1975).

[5]33 U.S.C. § 1314(a) (Supp. V 1975); 42 U.S.C. § 1857c-4 (1970).

[6]33 U.S.C. § 1342(a) (Supp. V 1975); 42 U.S.C. § 1857c-8 (1970).

[7]33 U.S.C. § 1313(e)(2) (Supp. V 1975); 42 U.S.C. § 1857c-5(a)(1) (1970). For the interpretive EPA guidelines, see 40 C.F.R. §§ 50.1-.11, 124.1-.94 (1976).

[8]33 U.S.C. § 1313(e)(3) (Supp. V 1975); 42 U.S.C. § 1857c-5(a)(2) (1970).

[9]"[A]lthough approval of a state permit program is often referred to as a 'delegation' of the federal program to the states, an approved state progam operates under state statutes and the federal program is merely 'suspended' in that state." Robie, *The*

The states' reliance on federal pollution control models and guidelines has fostered similarities in terminology and enforcement methods between the federal and state environmental protection agencies; a similar relationship exists between the state and local environmental protection agencies.

This Note will familiarize the Indiana attorney with the organization, statutory requirements, and regulations of the Indiana environmental protection agencies, as well as their ties to the Environmental Division of the Attorney General's office and the local environmental protection agencies. Each state agency will be examined in light of the impact of the EPA's policies and federal environmental protection legislation. The reader should be especially alert to the following problems in Indiana environmental practice: overlapping jurisdictions, areas of agency ineffectiveness, statutory biases, expected regulatory changes, and prosecutorial weaknesses. These issues permeate the field of environmental protection at every level of enforcement.

I. The Indiana Environmental Protection Agencies

The responsibility for environmental protection at the state level is divided between the Indiana Department of Natural Resources, the Indiana Attorney General's Environmental Division, and the Environmental Management Board of the Indiana State Board of Health. The Attorney General's Office handles the courtroom phase of the enforcement effort, while the day-to-day responsibilities of pollution control are vested primarily in the Environmental Management Board. The Board exercises jurisdiction over waters and wildlife areas concurrently with the Department of Natural Resources.

A. The Environmental Management Board

The Indiana Environmental Management Act[10] vests the eleven-member Environmental Management Board (EMB)[11] with full respon-

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Federal Water Pollution Control Act and the States: Love in Bloom or Marriage on the Rocks, 7 Nat. Resources Law. 231, 233 n.9 (1974). For the most part, the Indiana agencies have assumed full enforcement responsibility from the EPA, pursuant to the state statutes, and receive approximately equal federal and state funding. Interview with Mark S. Maxwell, Attorney for the Indiana Air Pollution Control Board, in Indianapolis (Jan. 27, 1977).

[10]Ind. Code §§ 13-7-1-1 to 13-7-18-1 (Burns 1973 & Supp. 1976).

[11]The Environmental Management Board (EMB) includes five ex officio members: the Secretary of the State Board of Health, the Director of the Department of Natural Resources, the respective chairmen of the Air Pollution and Stream Pollution Control Divisions, and the Director of the Division of Planning for the state. The six remaining

sibility to develop and update a long-term plan which will "ensure . . . the best possible air, water and land quality" for the state, to promulgate standards and regulations consistently with its long-range goals, to supervise the surveillance of all pollution sources, and to assist local governmental units in developing the programs and facilities needed to reduce the environmental pollution generated within their jurisdictions.[12] The EMB's statutory scope also embraces the power to grant permits for the installation, construction, or modification of equipment relating to air or water pollution, garbage or refuse disposal, and atomic or noise radiation.[13]

The EMB superintends the activities of the Air Pollution Control Board and the Stream Pollution Control Board. These two divisions of the EMB now exercise many of the enforcement powers formerly exercised by the federal EPA subsequent to the EPA's approval of the Indiana State Implementation Plan.[14] In reality, the two boards grant and enforce Indiana's air, water, and solid waste permits, relying on the EMB only in its advisory and liaison capacity with the State Board of Health, the parent agency.[15]

1. The Air Pollution Control Board

a. The Statutory Requirements

The Indiana Air Pollution Control Act directs the Air Pollution Control Board (APCB)[16] to "safeguard the air resource through the prevention, abatement and control of air pollution by all practical and economically feasible methods."[17] However, the Act distributes

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members, two of which must represent the public at large, are appointed by the Governor for four-year terms. Representatives of municipal government, agriculture, labor, and industrial management are each entitled to one board position. IND. CODE §§ 13-7-2-2 to -3 (Burns 1973).

The Assistant State Health Commissioner serves as the EMB Technical Secretary, *id.* § 13-7-2-2, and is responsible for administering the Board's operations, recording all EMB proceedings, coordinating the divisional activities, drafting the Governor's annual EMB report, *id.* § 13-7-2-6, and preparing the proposed budget for the EMB and its divisions, *id.* § 13-7-2-7. In short, the Technical Secretary directs the day-to-day operations of the various state environmental protection agencies.

[12] *Id.* § 13-7-3-1 (Burns Supp. 1976). Other EMB divisions include Sanitary Engineering, Radiological Health, and Industrial Health. Interview with Robert G. Grant, Attorney for the Indiana Stream Pollution Control Board, in Indianapolis (Nov. 18, 1976).

[13] IND. CODE § 13-7-10-1 (Burns 1973).

[14] *See* note 9 *supra* and accompanying text.

[15] Interview with Robert G. Grant, *supra* note 12.

[16] IND. CODE §§ 13-1-1-1 to -10 (Burns 1973).

[17] *Id.* § 13-1-1-1. For definitions of "air pollution" and "air contaminant," *see id.* § 13-1-1-2(c) to (d).

the necessary powers and duties between the APCB and its parent agency, the Indiana State Board of Health. The latter agency is empowered to interact with state, local, and federal units of government; administer budgetary expenditures to the APCB and local units of government; and generally encourage cooperation between the parties involved in the overall enforcement effort.[18] The APCB is vested with the power to investigate violations, hold hearings, enter orders, and promulgate "regulations consistent with the general intent and purposes of [the Indiana Air Pollution Control Act]."[19]

In formulating such orders and the determinations therein, the Board must engage in a nuisance-type balancing process,[20] considering:

> (a) The character and degree of injury to, or interference with, comfort, safety, health, or the reasonable use and enjoyment of property; (b) The social and economic value of the activity causing the emissions; and (c) The practicability, both scientific and economic, of reducing or eliminating the emissions resulting from such activity.[21]

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[18] *Id.* § 13-1-1-4(B).

[19] *Id.* (A). The directives of the APCB are carried out by the Air Pollution Control Division (APCD), which is divided into four major branches: standards and planning, monitoring, program support, and enforcement. The Monitoring Branch includes ambient and emissions sampling, quality assurance, and the laboratory. The Program Support Branch encompasses staff services, computer and data management, and local agency coordination. The Enforcement Branch is comprised of sections on compliance tracking, surveillance and investigations, and permits. Two other branches, administrative and legal, are directly under the supervision of the APCB's director. Interview with Mark S. Maxwell, Attorney for the Indiana Air Pollution Control Board, in Indianapolis (Nov. 23, 1976).

All regulations, permits, variances, final orders, and related actions of the APCD must be approved by its governing body, the seven-member APCB. IND. CODE § 13-1-1-4 (Burns 1973). The Indiana Secretary of State is an ex officio member of the Board and the Governor appoints the remaining six members. These appointments must include a doctor, an engineer, and representatives from agriculture, industry, municipal government, and the general public. The Governor may remove any member for cause. *Id.* § 13-1-1-3. However, the Clean Air Act Amendments of 1977 require this section to be amended to include in the APCB "a majority of members who represent the public interest and do not derive any significant portion of their income from persons subject to permits or enforcement orders under this Act." Pub. L. No. 95-95, § 128, 91 Stat. 685 (1977) (to be codified at 42 U.S.C. § 7428).

[20] *E.g.*, Boomer v. Atlantic Cement Co., 26 N.Y.2d 219, 257 N.E.2d 870, 309 N.Y.S.2d 312 (1970); Northern Ind. Pub. Serv. Co. v. W. J. & M. S. Vesey, 210 Ind. 338, 200 N.E. 620 (1936). The Indiana Air Pollution Control Act also declares that "[t]he discharge into the outdoor atmosphere of air contaminants so as to cause air pollution and create a public nuisance is contrary to the public policy of the state of Indiana and the provisions of this act." IND. CODE § 13-1-1-7 (Burns 1973).

[21] IND. CODE § 13-1-1-4(A)(2)(a) to (c) (Burns 1973).

This statutory orientation toward nuisance theory is compatible with the stated purpose of the Act: "to maintain the purity of the air resource of the state, which shall be consistent with protection of the public health and welfare and the public enjoyment thereof, physical property and other resources, flora and fauna, maximum employment and full industrial development of the state."[22] The above wording raises doubts as to whether the Indiana legislature sought only to "maintain" the current air quality at a level sufficient to prevent harm to persons and property or whether it sought to generally improve the state's air quality to a point of undefined purity.[23] However, the Act's nuisance approach is more consistent with the former interpretation. In balancing the above interests, the APCB must consider the economic well-being of the state in establishing pollution abatement programs by limiting pollution control methods to those which are "practical and economically feasible."[24] The agency's promulgation power is further confined to those "codes, rules and regulations" which are "clearly premised upon scientific knowledge of causes as well as of effects."[25]

In addition to these literal state statutory directives, the APCB looks to the federal Clean Air Act Amendments of 1970 and the EPA guidelines implementing the Amendments for considerable guidance. This federal input reduces the influence of economic and technological considerations on the formulation of state enforcement measures and brings the APCB's enforcement more into line with the policies of the Amendments and Congressional intent than it would have been under state law alone.[26] The Clean Air Act Amendments of 1970 compel the EPA to consider only the listed factors in section 110(a)(2)(A) through (H),[27] implicitly excluding economic and technological considerations from the EPA's review of a state implementation plan for approval.[28] This exclusion also enters into EPA's formulation of federal enforcement measures where the state implementation plan or the state enforcement has been ineffective in meeting the federal standards.

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[22] *Id.* § 13-1-1-1.

[23] Based on *id.* § 13-1-1-4(A)(2), the Newton Circuit Court recently set aside an APCB enforcement order against an open burning violation because of the Board's failure to base the required findings of fact on substantial evidence. Karlock v. Indiana Pollution Control Bd., No. C76-87 (Ind., Newton Cir. Ct. Feb. 17, 1977).

[24] IND. CODE § 13-1-1-1 (Burns 1973).

[25] *Id.*

[26] Interview with Mark S. Maxwell, Attorney for the Indiana Air Pollution Control Board, in Indianapolis (June 15, 1977).

[27] 42 U.S.C. § 1857c-5(a)(2)(A) to (H) (1970).

[28] Union Elec. Co. v. EPA, 427 U.S. 246, 257 (1976).

Thus, although the EPA is precluded from unevenly distributing the burden of pollution abatement on the basis of economic cost and technological feasibility, the APCB is obliged to consider economics and technology in formulating its regulatory measures,[29] giving rise to special interest provisions and exemptions. This state flexibility continues to provide great incentives to the states to obtain EPA approval of their state implementation plans, so as to eliminate federal enforcement.[30]

b. The Regulatory Scheme

Although initially promulgated by the APCB, the current regulations effectuating the directives of the Indiana Air Pollution Control Act were in part shaped by EPA's disapproval and suggested revision of certain provisions[31] according to EPA guidelines.[32] These regulations allow the APCB to alleviate the pollution abatement burden on certain pollution sources, while imposing more stringent standards on sources more able to comply with the requisite standards. For example, sources discharging smoke-like emissions may fall within the purview of several APCB regulations or their exceptions. Open burning is prohibited, but backyard incineration, recreational campfires, agricultural open burning, and incineration to dispose of explosives are expressly exempted from the regulation's scope.[33] The enforcement of this regulation depends principally on local citizens' reports and is seemingly proportional to the outrage of the community.[34]

Smoke may also violate the visible emissions standard, which limits the opaqueness of all air emissions, making it "the most powerful regulation on the books, because it is so easy to use."[35] The APCB merely presents the opaqueness observations of its trained "smoke readers" as prima facie evidence of a violation; industry must then assume the burden of proof to refute the agency's evidence by means of its own monitoring results.[36] Some smoke may contain "particulate emissions" large enough to be affected by

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[29]*Compare* 42 U.S.C. § 1857c-5(a)(2) (1970) *with* IND. CODE § 13-1-1-1 (Burns 1973).

[30]Interview with Mark S. Maxwell, *supra* note 26.

[31]*See* 40 Fed. Reg. 50,032 (1975); 41 Fed. Reg. 7450; 18,654; 32,304; 35,676 (1976).

[32]For EPA guidelines on the states' preparation, adoption, and submittal of state implementation plans, see 40 C.F.R. §§ 52.01-.23 (1976).

[33]In emergency circumstances, any permit applicant may apply to APCB for a special exemption. IND. ADMIN. RULES & REG. § (13-1-1-4)-1 (Burns 1976).

[34]Mannweiler, *All Fired Up About Smoke*, The Indianapolis News, Nov. 17, 1976, at 11, col. 1.

[35]Williams, *Indiana Air and Water Laws*, in FIFTH ANNUAL ENVIRONMENTAL SYMPOSIUM, CENTRAL INDIANA TECHNICAL SOCIETIES 21, 22 (1976).

[36]IND. ADMIN. RULES & REG. § (13-1-1-4)-2 (Burns 1976). The regulation allows a maximum fifteen minutes of noncompliance per day per source, but this provision will

gravity. Each source's particulate emission limitation, measured in pounds emitted per hour, is proportional to its production capacity, as computed by its combustion capacity[37] or its process weight rate.[38]

Major stationary pollution sources must continuously monitor their emissions and forward the results to the APCB, to be supplemented by APCB spot checks and stack tests.[39] In the state implementation plan, pursuant to federal guidelines,[40] APCB states that all stationary sources[41] will be inspected on a routine and periodic basis by the staff. "The purpose of the inspections shall be to insure compliance with the air pollution regulations, check on maintenance of air pollution control equipment, verification of compliance with permit conditions, and to forestall the development of air pollution problems."[42] These routine APCB inspections supplement the self-monitoring data required of major point sources[43] and the regional samples jointly collected by the APCB and the EPA.[44] In order to escape detection, a point source violating its permit would have to avoid the scrutiny of this three-pronged inspection routine.

Excessive particulate matter which escapes beyond the property on which the source is located may violate the APCB regulation on "fugitive dust."[45] Those dust particles that are within a specified diameter range possess the potential for causing respiratory damage[46] and are subject to the strictest regulation. However, the

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soon be stricken to comply with EPA directives. Another provision in the regulation causing EPA concern allows no greater than 60% opaqueness for a stated period when lighting or cleaning a boiler. If a malfunction occurs, the source must remain within 90% compliance in order to continue operating. See Williams, *Indiana Air and Water Laws*, *supra* note 35, at 24.

[37] IND. ADMIN. RULES & REG. §§ (13-1-1-4)-3, -6 (Burns 1976).

[38] *Id.* § (13-1-1-4)-4, -5.

[39] *Id.* § (13-1-1-4)-23.

[40] Indiana Air Pollution Control Board, Draft—State Implementation Plan—Rewrite §§ 6, 10-2 (October 1975) (unpublished plan available at Indiana State Board of Health, Air Pollution Control Board, 1330 W. Michigan St., Indianapolis, Ind. 46206), follows the federal mandate of 42 U.S.C. § 1857c-5(a)(2)(C), (F) (1970).

[41] A stationary source is "any machine, device, apparatus, equipment, installation, building, or other physical facility which emits or has the potential to emit any air contaminant." IND. ADMIN. RULES & REG. § (13-7-10-1)-21(a) (Burns 1976).

[42] Indiana Air Pollution Control Board, Draft—State Implementation Plan—Rewrite § 10-2, *supra* note 40.

[43] A point source is "any discernible, confined and discrete conveyance, including but not limited to any pipe, ditch, channel, tunnel, conduit, well, discrete fissure, container, rolling stock, or vessel or other floating craft from which pollutants are or may be discharged." IND. ADMIN. RULES & REG. § (13-7-10-1)-1(a)(23) (Burns 1976).

[44] Indiana Air Pollution Control Board, Draft—State Implementation Plan—Rewrite §§ 6, 10-2, *supra* note 40.

[45] IND. ADMIN. RULES & REG. § (13-1-1-4)-30 (Burns 1976).

[46] *Id.* § (13-1-1-4)-30(1)(b).

regulation expressly exempts most steam discharges, dust from some unpaved roads, as well as construction and agricultural operations where every reasonable precaution has been taken, violations caused by adverse weather conditions, and adequately dispersed visible emissions which comply with all other regulations.[47]

The Clean Air Act Amendments of 1970 stipulate that reductions in the atmospheric concentrations of certain pollutants are necessary to protect the public health and welfare. Every approved state implementation plan must include the regulatory means with which to attain and maintain the acceptable atmospheric concentrations,[48] known as ambient air quality standards.[49] The 1970 Amendments required compliance by the end of 1975 with the less stringent primary ambient air quality standards, which are intended to protect the public health;[50] the stricter secondary ambient air quality standards, which are designed to protect public welfare, must be attained within a "reasonable" time period.[51] The designated ambient air quality pollutants—sulfur dioxide, suspended particulate matter, carbon monoxide, photochemical oxidants, hydrocarbons, and nitrogen dioxide[52]—comprise the heart of the APCB's regulatory effort. Excessive levels of these pollutants will set into action the state regulation providing for air pollution forecasts, alerts, warnings, and emergencies.[53]

Out of the six ambient air quality standards, the sulfur dioxide emission standards contained in APC 13[54] have generated the most controversy. In a successful court battle brought by several Indiana electric power utilities, this regulation was declared invalid because of the APCB's failure to comply with the statutory procedural re-

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[47]*Id.* § (13-1-1-4)-30(6).

[48]The federal statute governing the promulgation of state implementation plans is contained in the Clean Air Act Amendments of 1970, § 110, 42 U.S.C. § 1857c-5 (1970) and clarified in 40 C.F.R. §§ 51.1-.23, 52.1-.23 (1976).

[49]The specific ambient air quality standards are set out in 40 C.F.R. §§ 50.4-.11 (1976).

[50]42 U.S.C. § 1857(a)(2)(A)(i) (1970). Indiana failed to meet the 1975 deadline imposed by the Clean Air Act Amendments of 1970. Interview with Mark S. Maxwell, Attorney for the Indiana Air Pollution Control Board, in Indianapolis (Jan. 27, 1977). *See also* text accompanying note 69 *infra.*

[51]42 U.S.C. § 1857c-5(a)(2)(A)(ii) (1970).

[52]40 C.F.R. §§ 50.4-.11 (1976); IND. ADMIN. RULES & REG. § (13-1-1-4)-31 (Burns 1976).

[53]IND. CODE § 13-1-1-7 (Burns 1973).

[54]IND. ADMIN. RULES & REG. § (13-1-1-4)-25 (Burns 1976). The air and stream pollution regulations are denoted by the initials APC or SPC, followed by the agency's regulation number. This notation is independent of the Burns regulation citation system.

quirements for adoption of rules and regulations.[55] Because these power plants generate approximately three-quarters of the state's sulfur dioxide pollution,[56] they will eventually face three alternatives in cutting their sulfur dioxide output: remove the sulfur from the coal, remove the sulfur dioxide from the exhaust, or convert to low-sulfur coal.[57] None of these alternatives will be cheap or popular, especially as the energy crisis intensifies.

As now written, Regulation APC 13 computes each source's allowable sulfur dioxide emissions on the basis of the average smokestack heights, the number of smokestacks, and the heat-producing capacity of the source.[58] Because of this reliance on dispersion tactics instead of reduced emissions, the areas downwind of sulfur dioxide sources acquire an increased "background" concentration of sulfur dioxide pollution, which may go undetected and unaccounted for in rural air quality regions. Unvarying wind patterns, a factor not taken into account by Regulation APC 13, can result in increased downwind concentration of sulfur dioxide, which could virtually destroy plant life.

The smokestack heights and emission limits for Regulation APC 13 and other emission standards were recommended by the American Society for Mechanical Engineers but their study omitted research on adverse health and vegetation effects and was "silent . . . in the selection of the maximum allowable ground level concentration."[59] Thus, several of the APCB's gaseous emission standards are based on an engineering model which fails to take into effect the local meteorological conditions and the health of organisms living within range of the smokestacks.

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[55]Indiana-Kentucky Elec. Corp. v. Indiana Envir. Management Bd., No. C73-675 (Ind., Marion Cir. Ct. Nov. 10, 1975), *appeal docketed*, No. 2-576A-180 (Ind. Ct. App. May 10, 1976). The circuit court ruling also declared APC 14, APC 19, and APC 22 invalid, but stayed execution of the requested injunction against the APCB, pending appeal. Meanwhile, the Board continues to enforce all four regulations.

[56]Indiana Air Pollution Control Board, The Background and Philosophy of Regulation APC 13 on Maximum Allowable Sulfur Dioxide Emissions 2 (Sept. 2, 1970) (unpublished report available at Indiana State Board of Health, Air Pollution Control Board, 1330 W. Michigan St., Indianapolis, Ind. 46206).

[57]D. CURRIE, POLLUTION, CASES AND MATERIALS 10 (1975).

A fourth temporary alternative lies in the discretionary relaxation of air quality standards during energy crises. 42 U.S.C. § 1857c-10(B) (Supp. V 1975). Additionally, the Clean Air Act Amendments of 1977 give the President nondelegable authority to temporarily suspend provisions of a state implementation plan during an energy or economic emergency. Pub. L. No. 95-95, § 107(a), 91 Stat. 685 (1977) (to be codified at 42 U.S.C. § 7410).

[58]IND. ADMIN. RULES & REG. § (13-1-1-4)-25 (Burns 1976).

[59]Indiana Air Pollution Control Board, The Background and Philosophy of Regulation APC 13 on Maximum Allowable Sulfur Dioxide Emissions 3, *supra* note 56.

The EPA and several environmental groups have voiced concern over increases in background sulfur dioxide concentrations and have challenged several states' "tall stack" regulations, claiming that the Clean Air Act Amendments of 1970 implicitly contain a legislative policy of pollution reduction, not dispersion.[60] This view has been adopted by several circuits[61] and the EPA has issued a guideline which cites those circuits' holdings for the proposition that section 110(a)(2)(B) of the Clean Air Act Amendments of 1970 requires constant emissions limitations, not dispersion-dependent technology. However, "where constant emission limitations [are] employed to the maximum extent achievable, it would then be appropriate to permit the use of dispersion techniques where necessary to achieve ambient standards."[62]

Five of the air quality criteria pollutants—nitrogen dioxide, carbon monoxide, hydrocarbons, suspended particulate matter, and photochemical oxidants—interact in the presence of sunlight[63] to form what is commonly known as "smog."[64] As the humidity rises, suspended particulate matter and sulfuric acid droplets scatter and absorb the light, decreasing visibility. Nitrogen dioxide is responsible for the "whiskey-brown" color common to smog.[65]

Carbon monoxide is the only air quality criteria pollutant which is colorless and odorless. It is a product of the gasoline engine's incomplete combustion and adversely affects health by impairing vision, slowing reaction timing, and aggravating heart disease.[66] At-

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[60]Stack Height Increases Guideline—Air Quality Standards, 41 Fed. Reg. 7450 (1976).

[61]NRDC v. EPA, 489 F.2d 39 (5th Cir. 1974); Big Rivers v. EPA, 523 F.2d 16 (6th Cir. 1975); Kennecott Copper Corp. v. Train, 526 F.2d 1149 (9th Cir. 1975), *cert. denied*, 425 U.S. 935 (1976).

[62]41 Fed. Reg. 7450 (1976).

[63]Pollutants which require the sun's energy as a catalyst in order to form smog are known as photochemically active pollutants.

[64]Although smog was initially thought to be caused by the combination of smoke and fog, scientists now theorize that branched chain hydrocarbons and nitrogen oxides react to form ozone in the presence of sunlight, resulting in the onset of smog. J. ROBERTS, R. STEWART, & M. CASERIO, ORGANIC CHEMISTRY, METHANE TO MACROMOLECULES 58 (1971) [hereinafter cited as ORGANIC CHEMISTRY]. Ozone is a highly reactive substance which cracks rubber, etches stone, damages plants, aggravates respiratory diseases, discolors dyes, and contributes to the intensity of smog. Sulfur dioxide may also add to the haze by reacting with water present in the air to form tiny droplets of sulfuric acid. Indiana Air Pollution Control Board, Background for Proposed Ambient Air Quality Standards for Carbon Monoxide, Ozone and Photochemical Oxidants, and Hydrocarbons, Table 2 (Dec. 17, 1970) (unpublished report available at Indiana State Board of Health, Air Pollution Control Board, 1330 W. Michigan St., Indianapolis, Ind. 46206); D. CURRIE, POLLUTION, CASES AND MATERIALS 15 (1975).

[65]D. CURRIE, POLLUTION, CASES AND MATERIALS 15 (1975).

[66]Indiana Air Pollution Control Board, Background for Proposed Ambient Air

mospheric concentrations of carbon monoxide are already so high in heavy downtown traffic in large cities that they pose immediate health problems.[67]

The EPA has estimated that the federal vehicle emissions control programs will eventually result in an eighty-percent nationwide decrease from the 1967 carbon monoxide automobile emission levels, and predicts similar reductions for other air quality criteria pollutants.[68] Relying on the supposed effectiveness of the federal program in abating mobile source pollution,[69] the APCB drafted its air quality criteria pollutant control regulations to apply to stationary sources only.[70] After delays in the federal program the APCB discovered that the abatement of stationary source pollution alone in the Indianapolis area would not be sufficient to meet the 1975 EPA-imposed deadline for attaining the primary ambient air standards.[71] The EPA then proposed a plan to restrict automobile use, to encourage mass transit, and to control traffic in the downtown area. The city administration was appalled; such a plan would cripple the rebirth of the inner city and give rise to more urban sprawl. After a city study raised doubts as to the effectiveness of the EPA's transportation control plan, the APCB and the EPA reached a compromise by instituting motor vehicle inspections and a hydrocarbon vapor recovery recycling program at local gas stations. The latter measure was designed to abate a sizable cause of

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Quality Standards for Carbon Monoxide, Ozone and Photochemical Oxidants, and Hydrocarbons, Table 1, *supra* note 64.

[67]ORGANIC CHEMISTRY, *supra* note 64, at 58.

[68]Indiana Air Pollution Control Board, Draft—State Implementation Plan—Rewrite 3-75, *supra* note 40. Originally the EPA attempted to wage a two-pronged attack against motor vehicle pollution, but recent court challenges have thwarted proposed EPA transportation control plans. District of Columbia v. Train, 521 F.2d 971 (D.C. Cir. 1975), *vacated*, 97 S. Ct. 1635 (1977); Brown v. EPA, 521 F.2d 827 (9th Cir. 1975), *vacated*, 97 S. Ct. 1635 (1977). In addition, Congress is contemplating another year's extension for compliance with the vehicle emissions control standards. Clean Air Act Amendments of 1977, Pub. L. No. 95-95, § 201, 91 Stat. 685 (to be codified at 42 U.S.C. § 7521). See the provision of the 1977 Amendments which forbids the approval of certain federal grants to specified areas not utilizing transportation control plans. *Id.* § 176(a) (to be codified at 42 U.S.C. § 7506).

[69]42 U.S.C. §§ 1857f-5(a) to -12 (1970 & Supp. V 1975).

[70]Stationary sources, especially petroleum refineries, ferrous metal smelters, and refuse incinerators emitting carbon monoxide are required to burn the stream of waste gases in a direct flame afterburner or control the emission "by other means approved by the Board." IND. ADMIN. RULES & REG. § (13-1-1-4)-28 (Burns 1976). Nitrogen oxide emission limits for stationary sources are specified in pounds of nitrogen dioxide emissions per unit of heat input, based on whether the source is gas, oil, or coal fired. *Id.* § (13-1-1-4)-29.

[71]Indiana Air Pollution Control Board, Draft—State Implementation Plan—Rewrite 3-75, *supra* note 40.

hydrocarbon pollution: the evaporation and spillage of gasoline.[72] This hydrocarbon emission regulation also controls the storage, loading, processing, and disposition of volatile organic materials and solvents.[73] The APCB possesses the power to evolve stricter standards for sources whose hydrocarbon emissions may pose a health hazard.[74] Patterned after a federal model regulation that was based on Los Angeles smog chamber tests,[75] this regulation exempts some hydrocarbons according to their lack of chemical reactivity and their inability to form smog.[76]

Any stationary pollution source that constructs or operates any air pollution control device must obtain an APCB permit.[77] Regulation APC 19 requires any source constructing, installing, or modifying pollution control equipment to first obtain a construction permit,[78] while a source already in operation or production must possess an operation permit.[79] To obtain either permit, the applicant must demonstrate that the source will operate in compliance with federal and state standards and will maintain the current air quality if it is better than the minimum standards.[80] Local units of government may enforce their own more restrictive regulations or may be given the responsibility of enforcing the state permit program.[81]

Permit holders should note that the "issuance and possession of any permit shall not constitute a defense of a violation of any law, regulation or standard."[82] If a pollution source is in violation of a given regulation or the terms of its permit, the APCB first revokes or denies the operating permit. At a meeting with the violator the agency attempts to arrange a provisional permit, a compliance timetable, or an agreed order. If the parties cannot reach an agreement, a hearing is called before an officer appointed by the APCB,

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[72]Interview with James Elam, Administrative Assistant for the Indianapolis Air Pollution Control Division, in Indianapolis (Nov. 24, 1976).

[73]IND. ADMIN. RULES & REG. § (13-1-1-4)-27 (Burns 1976).

[74]*Id.* § (13-1-1-4)-27 (8)(d).

[75]Interview with William Schoonmaker, Chief of Standards Section, Indiana Air Pollution Control Division, in Indianapolis (Feb. 24, 1977).

[76]IND. ADMIN. RULES & REG. § (13-1-1-4)-27(8)(b) (Burns 1976).

[77]*Id.* §§ (13-7-10-1)-22 to -27.

[78]*Id.* § (13-7-10-1)-22.

[79]*Id.* § (13-7-10-1)-23.

[80]*Id.* §§ (13-7-10-1)-22(b), -23(e). *See* Significant Deterioration of Air Quality, 40 C.F.R. § 52.21 (1976), *and* the Clean Air Act Amendments of 1977, Pub. L. No. 95-95, §§ 160-169, 91 Stat. 685 (1977) (to be codified at 42 U.S.C. §§ 7470-7479), which require state implementation plans to meet even more stringent requirements for the prevention of significant deterioration.

[81]*Id.* § (13-7-10-1)-27. *See* text accompanying notes 155-165 *infra.*

[82]*Id.* § (13-7-10-1)-26.

whose findings of fact may be revised, rejected, or accepted by the Board.[83] Any further appeal moves into the appropriate state circuit court, where civil and criminal penalties, as well as cease and desist orders, may be imposed on the violator.[84]

A source may obtain a one-year variance under the state Environmental Management Act, exempting it from certain regulations, but the variance applicant must demonstrate that it would sustain an undue burden if it were immediately required to comply with the applicable standards.[85] In practice, variances are granted for financial hardship or pending research aimed at correcting the problem for which the source was cited, but they are rarely granted consecutively. The agencies prefer to grant compliance schedules[86] because they require the source to take certain steps toward compliance during the compliance schedule period. Of course, a violator can immediately comply with emissions standards by terminating its operation, but both the source and the agency generally seek to avoid this alternative.[87]

2. Stream Pollution Control Board

a. Statutory Requirements

The Stream Pollution Control Board's (SPCB) organization, statutory provisions, and relationship with the EPA parallel that of its sister board, the Air Pollution Control Board.[88] The Indiana Water Pollution Control Act designates the SPCB as the state's "water pollution agency" for the purposes of the Federal Water Pollution Control Act.[89] The 1972 Amendments to the latter Act define the "state water pollution control agency" to be that state agency which enforces state laws on water pollution control and solid waste disposal.[90]

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[83] IND. CODE §§ 13-7-11-1 to -5 (Burns 1973); interview with Mark S. Maxwell, *supra* note 19; interview with Robert G. Grant, *supra* note 12.

[84] IND. CODE §§ 13-7-13-1, -3 (Burns 1973).

[85] *Id.* § 13-7-7-6.

[86] IND. ADMIN. RULES & REG. §§ (13-7-10-1)-1(27), (13-7-10-3)-19 (Burns 1976). The Clean Air Act Amendments of 1977 now forbid the issuance of compliance orders without public notice and hearing, the inclusion of scheduled interim requirements, EPA approval as to major sources, and noncompliance penalties. Pub. L. No. 95-95, §§ 111-112, 91 Stat. 685 (1977) (to be codified at 42 U.S.C. § 7413).

[87] Interview with Mark S. Maxwell, *supra* note 19.

[88] *See* notes 16-19 *supra* and accompanying text. The SPCB is comprised of four gubernatorial appointees and three ex officio members: the Director of the Department of Conservation, the Secretary of the State Board of Health, and the Lieutenant Governor. IND. CODE § 13-1-3-2 (Burns 1973).

[89] IND. CODE § 13-1-4-2 (Burns 1973).

[90] 33 U.S.C. § 1362(1) (Supp. V 1975).

As with the APCB, many of the SPCB's regulations were drafted to comply with the concurrent federal legislation.[91] The Federal Water Pollution Control Act Amendments of 1972 replaced the water quality standards of its forerunner with specific effluent limitations on water pollution.[92] The jurisdiction of the Amendments encompasses all "navigable waters," including oceanic waters within three miles of the American shore, "ground waters," and "surface and underground waters."[93] With several exceptions, the effluent limitations must be based on the "best practicable available technology" by July 1, 1977,[94] and on the "best available technology economically achievable" by July 1, 1983.[95] In anticipation of a controversy paralleling the litigation over the use of dispersion methods in complying with the Clean Air Act Amendments of 1970,[96] the Federal Water Pollution Control Act Amendments of 1972 expressly forbade the use of dilution methods "as a substitute for adequate treatment . . . at the [pollution] source."[97]

The 1972 Amendments instituted a National Pollutant Discharge Elimination System (NPDES),[98] whereby all point source pollutant discharges are unlawful unless they comply with the terms of the source's NPDES permit.[99] In a statutory approach reflecting that of the Clean Air Act Amendments of 1970, the NPDES program encourages each state to draft a state implementation plan sufficient to enforce the effluent limitations and goals of the Federal Water Pollution Control Act Amendments of 1972.[100] Upon the EPA's approval,[101] the state's NPDES permit program would operate in lieu of the federal program under the auspices of the federally designated state water pollution agency.[102]

b. The Regulatory Scheme

The NPDES regulatory guidelines[103] were adopted in entirety in the Indiana Water Pollution Control Act and its accompanying

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[91] *See* notes 4, 31, & 32 *supra* and accompanying test.

[92] 33 U.S.C. § 1311 (Supp. V 1975) (originally enacted as Water Pollution Control Act, Pub. L. No. 845, 62 Stat. 1155 (1948)).

[93] 33 U.S.C. §§ 1252(a); 1362(7),(8) (Supp. V 1975).

[94] *Id.* § 1311(b)(1)(A).

[95] *Id.* § 1311(b)(2)(A).

[96] *See* notes 58, 60-62 *supra* and accompanying text.

[97] 33 U.S.C. § 1252(b)(1) (Supp. V 1975).

[98] *Id.* § 1342.

[99] *Id.* § 1311(a).

[100] *See* text accompanying notes 6-9 *supra*.

[101] 33 U.S.C. §§ 1314(h)(2), 1342(b) (Supp. V 1975).

[102] *Id.* § 1342(c)(1).

[103] *Id.* § 1342(b); 40 C.F.R. §§ 124.1-.94 (1976).

regulations. Each permit holder must monitor the discharges which are not considered "minor," or which are specifically required to be monitored, or which contain some toxicity. Monitoring results must be reported to the SPCB,[104] which forwards them to the EPA. The SPCB field crew constantly performs spot checks on assigned sources in order to check the accuracy of these sources.[105]

A separate system of permits effectuates the SPCB's solid waste regulatory program, which requires special permits for industrial waste haulers,[106] sanitary landfill facilities,[107] and refuse processing facilities,[108] while municipal sewage treatment plants operate under both the NPDES and local permits.[109] Most cities operate a dual storm and sanitary sewer system, which generally meets SPCB standards; however, a heavy rainfall or an intentional sewer overflow may result in fresh sewage with a high ammonia content spilling into the streams, usually resulting in a violation of the source's permit and high fish mortality.[110] Due to the high cost of constructing new waste treatment facilities equipped to meet the federal effluent limitations, Congress provided for seventy-five percent federal funding of the cost of approved projects in the Federal Water Pollution Control Act Amendments of 1972.[111]

Regulation SPC 1R3 sets the water quality standards for most bodies of water in Indiana,[112] depending on their type of use, such as whole or partial body contact recreation, warm or cold water fish maintenance, public or industrial water supply, or agricultural purposes.[113] For each type of water use, the regulation specifies a variety of criteria, including pH and temperature ranges; taste and odor;

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[104]IND. ADMIN. RULES & REG. § (13-7-10-3)-24 (Burns 1976).

[105]Interview with Robert G. Grant, *supra* note 12.

[106]IND. ADMIN. RULES & REG. § (13-7-10-1)-38 (Burns 1976).

[107]*Id.* §§ (13-7-10-1)-55, -62.

[108]*Id.* §§ (13-7-10-1)-59, -76.

[109]33 U.S.C. §§ 1342, 1345 (Supp. V 1975); interview with James Elam, *supra* note 72.

[110]Interview with Robert S. Morse, Administrator of the Department of General Sanitation, Bureau of Environmental Health, Health and Hospital Corporation of Marion County, Indiana, in Indianapolis (Nov. 19, 1976).

[111]33 U.S.C. §§ 1281, 1282 (Supp. V 1975). For federal criteria for approval of funds, see *id.* § 1284(a).

[112]IND. ADMIN. RULES & REG. § (13-1-3-7)-1 (Burns 1976). Regulation SPC 1R3 does not apply to Lake Michigan, Wolf Lake, the Grand Calumet River, the Indiana Harbor Ship Canal, and privately owned ponds. Sections (13-1-3-7)-4 to -8 specify less stringent water quality criteria for all of the above except the private ponds. *Id.* §§ (13-1-3-7)-4 to -8. The Gary vicinity's water pollution regulations are now jointly administered by the SPCD and the EPA, due to the immensity of the local pollution problems and the political pressures. Interview with Robert G. Grant, *supra* note 12.

[113]IND. ADMIN. RULES & REG. § (13-1-3-7)-1(3)(a) (Burns 1976).

toxicity; dissolved solid and oxygen concentrations; and bacterial, chemical, and radioactive content.[114] Where multiple uses are designated, the most protective criteria will determine the standards[115] and where the existing waters are currently of higher quality than the applicable standards, such quality may not be degraded.[116] The designated use standards do not apply within the dispersion area of each pollution source's waste effluent and the receiving body of water, the latter's use designation, the dilution ratio, and the synergistic and aggregate effects of nearby discharges.[117] However, all waters, including the mixing zone, must be free of substances which are putrescent, unsightly, harmful, or toxic, or which constitute a nuisance.[118]

Drainage of cyanide or related compounds into sewer systems or waterways is forbidden, except with prior SPCB approval.[119] Coal mine owners are required to dispose of their mining refuse so as to minimize acid mine drainage into state waters,[120] while spills[121] of oil and other hazardous or objectionable substances must immediately be contained and reported to the SPCB Technical Secretary, followed by a clean-up procedure which minimizes damage to public health, various biological entities, and the surrounding waters.[122]

A 1971 state statute limited and later banned the sale and use of phosphorus-containing detergents with certain exceptions.[123] Those sources falling within those exceptions must apply for a SPCB permit, wherein they must demonstrate that their use of the detergent is necessary and has no adequate substitute and that the phosphate will be removed from the effluent.[124] This detergent ban has been dramatically effective in reducing phosphate contamination in

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[114] *Id.* § (13-1-3-7)-1(6). Salmon spawning and migration waters are subject to more stringent standards. *Id.* § (13-1-3-7)-10.

[115] *Id.* § (13-1-3-7)-1(3)(b).

[116] *Id.* § (13-1-3-7)-1(1).

[117] *Id.* § (13-1-3-7)-1(4).

[118] *Id.* § (13-1-3-7)-1(6)(a).

[119] *Id.* § (13-1-3-7)-2.

[120] *Id.* § (13-1-3-7)-3. Hills of coal mine refuse, called "gob piles," generate large quantities of sulfuric acid due to the oxidation of the pyrites in coal particles by rain water seepage. King, *'Gob Pile' Bulldozed After 50-Year Growth*, The Indianapolis News, Nov. 29, 1976, at 18, col. 5.

[121] IND. ADMIN. RULES & REG. § (13-1-3-7)-12 (Burns 1976). This section defines a "spill" as "any unexpected, unintended, abnormal, or unapproved dumping, leaking, drainage, seepage, discharge or other loss . . . which enters or threatens to enter the waters of the state."

[122] *Id.* § (13-1-3-7)-13.

[123] IND. CODE § 13-1-5.5-3 (Burns 1973).

[124] IND. ADMIN. RULES & REG. § (13-1-3-7)-11 (Burns 1976).

various bodies of water and its accompanying side effects.[125] A federal study of twenty-seven Indiana lakes revealed a "marked improvement in phosphate concentration in the two years following the ban" in twenty-six of those lakes. However, the agency does concede that the increased additives in the newer non-phosphate detergents could create more exotic pollution problems.[126]

The SPCB's enforcement methods parallel those of the APCB,[127] initially relying on permits, compliance timetables, and agreed orders to bring sources into compliance with the state effluent limitations.[128] The Act specifies the procedures to be followed for notice to the violator, hearing and final order by the SPCB,[129] and subsequent court actions.[130]

B. Department of Natural Resources

The role of the Department of Natural Resources (DNR) in pollution control is peripheral to the primary efforts of the Air and Stream Pollution Control Boards. Although the DNR rarely deals with pollution sources, its state jurisdiction is concurrent with that of the SPCB with regard to all bodies of water stocked with fish, all bodies of water not enclosed by a single owner's land, and all waters facilitating the passage of fish.[131] The DNR's 167 conservation officers are vested with the power to arrest any person witnessed dumping "refuse" into the waters of the state.[132] The term "refuse" as defined in the statute includes many of the substances regulated by the SPCB, particularly "all putrescible and nonputrescible solid and semisolid wastes, including garbage, rubbish, ashes, street cleanings, dead animals, offal and solid commercial industrial and institutional wastes."[133]

A polluter causing a fish kill or other wildlife deaths within the bounds of DNR jurisdiction could face concurrent suits by the DNR

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[125]The phosphates in detergents and fertilizers inevitably seep into water supplies, stimulating algae growth while extinguishing other marine life and causing an accelerated aging of the lakes, called eutrophication. ORGANIC CHEMISTRY, *supra* note 58, at 528.

[126]*More Additives in Wash*, The Indianapolis News, Dec. 17, 1976, at 15, col. 4.

[127]*See* notes 83-84 *supra* and accompanying text.

[128]Interview with Robert G. Grant, *supra* note 12.

[129]IND. CODE § 13-1-3-9 (Burns 1973).

[130]*Id.* §§ 13-1-3-11, -12, -14, -15.

[131]*Id.* § 14-2-2-1 (Burns 1973); interview with Major John Hendricks, Conservation Law Enforcement Officer for the Department of Natural Resources, in Indianapolis (Nov. 18, 1976).

[132]IND. CODE § 14-3-11-1 (Burns 1973).

[133]*Id.*

in the form of misdemeanor charges,[134] a civil action for damages sustained from the fish kill,[135] and even a suit in equity to enjoin further pollution.[136] The DNR fish kill figures may also be incorporated into an SPCB complaint in the form of three counts against the offender: violation of the Indiana Water Pollution Control Act,[137] breach of the NPDES permit,[138] and damages for the fish kill.[139] As an SPCB attorney noted, a complaint with that much "ammunition" usually restrains the appellate judge from reducing the violator's fine.[140]

II. The Attorney General of Indiana

The Indiana Attorney General possesses the statutory authority to initiate all court actions on behalf of the EMB and its various agencies, including the APCB and the SPCB.[141] This arrangement bears a close resemblance to the federal enforcement scheme, wherein the EPA takes full responsibility for monitoring, drafting compliance orders, and even investigating violations,[142] but the Justice Department shoulders the burden of prosecution and litigation.[143]

At both the state and federal levels, this split enforcement scheme fosters common advantages and disadvantages. Although this detachment of the investigative staff from the litigative staff increases the possibility of errors by the Attorney General's staff at the hearing or trial stage, it encourages an objective review and evaluation process by the Attorney General's specialized Environmental Division as to whether the evidence compiled by the agency will support the proposed cause of action.[144]

In order to facilitate communication between the Environmental Division and the environmental agencies, a member of the Division

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[134] *Id.* § 14-2-3-8.

[135] *Id.* § 14-2-6-7.

[136] *Id.* § 14-3-1-14(8).

[137] *Id.* §§ 13-1-3-1 to 13-1-3-18.

[138] 33 U.S.C. § 1342 (Supp. V 1975); Ind. Admin. Rules & Reg. § (13-7-10-3)-27 (Burns 1976).

[139] Ind. Code § 14-2-6-7 (Burns 1973).

[140] Interview with Robert G. Grant, *supra* note 12.

[141] Ind. Code §§ 4-6-3-1, 4-6-5-3 (Burns 1974); *id.* §§ 13-1-1-7, 13-1-3-15, 14-2-6-7(2) (Burns 1973).

[142] *See* 33 U.S.C. §§ 1251-1376 (Supp. V 1975); 42 U.S.C. §§ 1857-1858 (1970 & Supp. V 1975).

[143] 28 U.S.C. §§ 515-516 (1970 & Supp. V 1975); 42 U.S.C. § 1857h-3 (1970).

[144] Interview with Michael Schaefer, Chief of the Environmental Division, Assistant Attorney General to Indiana Attorney General Theodore L. Sendak, in Indianapolis (June 15, 1977).

regularly attends meetings of the APCB and the SPCB.[145] Formal requests for legal action by the Attorney General may originate from the EMB, the APCB, the SPCB, or even from the EPA on referral.[146] In addition to environmental litigation, the Environmental Division also represents the Department of Mental Health, other State Board of Health agencies, and the Department of Natural Resources, resulting in a diverse spectrum of concurrent lawsuits.[147]

Although this arrangement maintains a semblance of amicability, Indiana Attorney General Theodore L. Sendak has sparked a controversy over the statutory power of the EMB, the APCB, and the SPCB to employ their own attorneys.[148] Much of this confusion can be traced to statutory ambiguities in the Environmental Management Act which states that the EMB, the APCB, and the SPCB may "conduct . . . or participate in conferences or hearings . . . concerning any matter within the scope of the power and duties of the board or the appropriate agency . . . ."[149] Furthermore, they may "[p]roceed in . . . court . . . by appropriate action, to enforce any order of the . . . agency; to collect any penalties . . . ; or to procure . . . compliance with . . . any regulation or standard of the board or agencies."[150] In order to carry out the above duties, they may "[e]mploy or contract for such legal, professional, and other personnel . . . as may be necessary for efficient performance of duties imposed by this article."[151]

On first reading, these statutory excerpts would seem to give the aforementioned agencies power to employ their own legal counsel, except when read in the context of another statute which requires any agency hiring an attorney to first obtain the written consent of the Attorney General.[152] Although the wording of this lat-

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[145] *Id.*

[146] *Id.* The Division may also file an amicus curiae brief in an ongoing lawsuit where the state has an interest in the outcome of the suit, but is not a party thereto for jurisdictional reasons or lack of standing. In U.S. Steel Corp. v. Train, Nos. 73H-190 & 77H-212 (N.D. Ind. June 16, 1977) (consent decree entered), Indiana filed an amicus curiae brief in a suit involving a Gary plant where EPA had taken over enforcement and permit responsibilities for the Gary area.

[147] Interview with Michael Schaefer, *supra* note 144.

[148] Hoffman, *Water Control Program May Prove Illegal*, The Indianapolis Star, Sept. 16, 1975, at 7, col. 1.

[149] IND. CODE § 13-7-5-1(f) (Burns 1973).

[150] *Id.* § 13-7-5-1(*l*).

[151] *Id.* § 13-7-5-1(k).

[152] "No agency . . . shall have any right to name, appoint, employ or hire any attorney, or special or general counsel to represent it or perform any legal service in behalf of such agency and the state without the written consent of the attorney-general." *Id.* § 4-6-5-3 (Burns 1974).

ter statute could admittedly be interpreted as not covering the hiring of advisory or "in-house" attorneys, a 1953 Attorney General's Opinion invalidated an employment contract and forbade payment for services of such an attorney for another state agency.[153]

Since the onset of the controversy in September 1975, no further action has been taken toward resolution,[154] perhaps indicating a softening of the Attorney General's stand on the issue to allow the hiring of agency attorneys as hearing officers and as legal advisors to review contracts, to draft regulations, and to advise the agency.

III. Local Environmental Agencies

A. Indianapolis Air Pollution Control Division

The Indianapolis Air Pollution Control Division (IAPCD) exemplifies the full range of responsibilities which can be assumed by a local agency from the state APCD, although other local air pollution control agencies may differ in their regulatory powers and unique pollution problems.

Although the IAPCD's parent agency is the Indianapolis Department of Public Works, the Division's budget is supplemented by EPA grants amounting to almost fifty percent of its total funding, and its personnel are trained in part at EPA seminars. The state APCB has delegated its enforcement power for the Indianapolis area to the IAPCD in a written contract which stipulates that the EPA can mandate changes in the local regulations.[155] The Division may also promulgate and enforce its own regulations, as long as they are more stringent than state and federal regulations.[156] Currently it has issued installation permits or operating certificates to approximately one thousand sources. The local laboratory and monitoring results are transmitted to an EPA computer in Texas which stores them for EPA use.[157]

Local enforcement proceeds on one of three alternatives: (1) a court appearance to impose a fine for each violation; (2) an agreed order signed by the agency and the offender, providing for the installation of pollution abatement equipment and the offender's continued good faith; or (3) a default on an agreed order, resulting in a breach of contract suit. The agency feels considerable local pressure from the mayor, the media, neighborhood associations, and citizens'

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[153][1953] Ind. Att'y Gen. Op. 284.

[154]Interview with Michael Schaefer, *supra* note 144.

[155]Interview with James Elam, *supra* note 72.

[156]Ind. Admin. Rules & Reg. § (13-7-10-1)-27 (Burns 1976).

[157]Interview with James Elam, *supra* note 72.

groups. The latter two types of organizations can, if necessary, sue the IAPCD in a class action for nonenforcement of an agreed order if they can prove the occurrence of an illegal emission and an injury to the neighborhood or class members.[158]

B. Marion County Health and Hospital Corporation

The Marion County Health and Hospital Corporation was established pursuant to the "Unigov" reorganization of the Indianapolis and Marion County governmental agencies in 1969.[159] The Corporation has the powers and responsibilities of a local health agency, including disease prevention and control, operation of hospital facilities, and related functions.[160]

The Corporation's Bureau of Environmental Health is responsible for local food, housing, and sanitation. In particular, the Sanitation Branch has jurisdiction over sewage, solid waste disposal, and stream pollution control, coinciding with, and, in some cases, conflicting with state SPCB regulations.[161] However, the major effort on the part of this agency is the regulation and surveillance of local sewer systems, water treatment plants, and land fill operations,[162] under the mandate of county ordinances and regulations, which incorporate the SPCB's water quality standards by reference.[163] Although the Health and Hospital Corporation is technically an SPCB subsidiary, it receives no funding or internal directives from the SPCB.[164] The local prosecutor's office represents the Corporation in judicial proceedings, after the Corporation has investigated the violation and handled the hearing.[165]

IV. The Dynamics of Environmental Enforcement—Conclusion

Since the inception of strong environmental legislation during

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[158] *Id.*

[159] The Unigov reorganization was accomplished pursuant to the Consolidated First-Class Cities and Counties Act, ch. 173, 1969 Ind. Acts 357 (now codified at Ind. Code §§ 18-4-1-1 to 18-4-24-25 (Burns 1974)).

[160] Ind. Code §§ 16-12-21-22, -28 (Burns 1973).

[161] Interview with Robert S. Morse, *supra* note 110. The Indiana Attorney General has ruled that county governments have no power to enact air pollution control ordinances, but that they may enter into the field of local water pollution control. [1967] Ind. Att'y Gen. Op. 430. Hence, the Indianapolis Air Pollution Control Division is under the auspices of the municipal government, while the Marion County Health & Hospital Corporation is a separate county-based corporation.

[162] Interview with Robert S. Morse, *supra* note 110.

[163] Marion County, Ind., Ordinance 6-1960, § 3 (Sept. 12, 1960) (incorporating by reference SPC 1R3, Ind. Admin. Rules & Reg. § (13-7-10-3)-24 (Burns 1976)). *See* text accompanying notes 112-118 *supra.*

[164] Interview with Robert S. Morse, *supra* note 110.

[165] *Id.*

the environmentally-concerned 1960's, the country's environmental conscience has been compromised by a severe recession and an energy crisis. The freewheeling economy of the 1960's has given rise to the tight-fisted 1970's, leaving this nation's populace to ponder whether the price we now pay in dollars and cents to abate pollution is on par with the price we will otherwise pay for environmental damage to person and property. Statistics now estimate that "as much as 8 to 21 percent of major U.S. industry capital expenditures in recent years has been for pollution control."[166] Without much statistical expertise, one realizes that these "capital expenditures" have been passed on to the consumer in the form of price increases, contributing to the inflationary trend.

The current situation leaves the state environmental agencies in a curious balancing predicament. In some instances, the state agency's formulation of its implementation plan and accompanying regulations becomes a tug-of-war between industry representatives and environmentalists, both parties holding their hard-line positions, neither willing to face the real dilemmas of environmental law. One dilemma is painfully clear to consumers who are indignant at industry's asserted right to use the air and water of their community as a convenient waste disposal system. When the cost to abate these practices comes out of the consumers' pockets in higher prices, fewer jobs, and possibly even industry shutdowns, the consumers soon clamor for less stringent regulations.

The other dilemma belongs to the administrator who wishes to follow the dictates of his agency's legislative mandate, but fears that burgeoning industry, labor, and municipal pressure may persuade the legislature to dilute the agency's powers if the agency enforces its mandate too stringently. Thus, the administrator becomes a crusader, not for the environment, but for the survival of his own agency. The legislature's susceptibility to pressure by big business forces the agency to change its "battle plan" from that of an offensive campaign against pollution sources to a defensive justifiction of its own existence. This further reduction in effectiveness leaves the agency open to valid criticism by environmentalists concerning its inability to devote its undivided attention to pollution abatement. Similarly, some local agencies are reluctant to fly in the face of strong community sentiment, especially in the light of rising unemployment and an energy crisis. The crux of these agencies' dilemma lies not in their organization or statutory mandate, but in the political system under which they were created.

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[166]Weston, *A Current Evaluation of Environmental Goals in the United States*, in FIFTH ANNUAL ENVIRONMENTAL SYMPOSIUM, CENTRAL INDIANA TECHNICAL SOCIETIES 33, 37 (1976).

The issues pertaining to state and local environmental enforcement are not brought into full focus without considering the federal role in pollution abatement. Numerous sources have criticized Congress' statutory dilution of an effective pollution control scheme, as well as its vacillating commitment on crucial pollution abatement issues. These practices have lent support to industry's reluctance to commit substantial capital resources to the goal of complying with federal pollution standards, some of which may have been eased by the time compliance is achieved. Industry compliance has been further retarded by the contradictions and contortions of a multilevel, overlapping permit system, for which the agencies have only themselves to blame. A little consistency and stability in the overall regulatory scheme would greatly contribute to positive environmental change.

Additional problems arise from the demands of EPA policies in general. Occasionally a state agency expends so much effort meeting EPA standards that it overlooks some local trouble spots. For example, a recent lead oxide contamination in the Indianapolis area took place principally because the EPA had not yet set air quality standards for that pollutant.[167] An agency attorney suggests that the EPA would be more valuable to the states in researching and advising the best method by which to bring specific industries into compliance, rather than mandating the pollution standard to be met without further guidance as to the most feasible method of abatement.[168]

Because of their dual dependence on federal as well as state funding,[169] the state environmental protection agencies may find themselves being drawn in diverse directions by state and federal pursestrings. Moreover, the EPA has the power to disapprove a state implementation plan, withdraw federal funding, and reinstate or initiate federal enforcement of the original EPA regulatory scheme.[170] Unlike the state agencies, the enforcement measures instituted by the EPA must be formulated without considering the economic cost and the technological feasibility of the required abatement methods.[171] Such a loss of state control in enforcement alternatives and the shift in enforcement responsibility to the EPA are so undesirable that both the state and federal officials strive to avoid the necessity of EPA enforcement, except in problem areas

[167]Interview with James Elam, *supra* note 72.

[168]Interview with Mark S. Maxwell, *supra* note 19.

[169]*See* note 9 *supra* and accompanying text.

[170]33 U.S.C. § 1342(c) (Supp. V 1975); 42 U.S.C. § 1857c-6 (1970).

[171]*See* Union Electric Co. v. EPA, 427 U.S. 246 (1976) (construing Clean Air Act Amendments of 1970, § 110(a)(2)(A) to (H), 42 U.S.C. § 1857c-5(a)(2)(A) to (H) (1970)).

where federal intervention is the only effective means of control.[172]

Although environmental enforcement has progressed considerably since the days of private civil litigation in nuisance theory, its statutory evolution is not yet complete. Federal, state, and local agencies are faced with the unenviable task of resolving the regulatory inconsistencies which currently hinder enforcement efforts. In particular, Indiana's recent environmental protection legislation has given rise to a segmentation of enforcement responsibilities between several state agencies, as well as a split in the investigative and the litigational powers. As with any newly designed strategy, several aspects of the system still require fine-tuning and revision by the agencies and the legislature in order to bring environmental enforcement into line with the lofty ideals of its conception.

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[172]For example, the Gary-East Chicago area is now under the exclusive jurisdiction of the EPA Region V office in Chicago. Interview with Mark S. Maxwell, *supra* note 50.

An Analysis of Corporate Transactions Involving Net Operating Loss Benefits

A multitude of tax considerations arise when one corporation purchases another. One of the major considerations is the net operating loss carryforward. Corporate planners are often confronted with the problem of whether the net operating losses previously incurred by the purchased corporation may be deducted by the purchasing corporation in future years. Another major consideration is the availability of net operating loss carrybacks in corporate reorganizations. The question raised here is whether the post-merger net operating losses generated by the purchasing corporation may be offset against the pre-merger taxable income of the acquired corporation.

Determining the availability of net operating loss deductions that may exist after corporate purchases and reorganizations is a complex task. However, the problem can be simplified by first examining the general concept of the net operating loss deduction. Based upon this examination, a more detailed analysis can be made of the intricate rules that control the availability of net operating loss deductions in corporate transactions.

The intent of this analysis is to better equip the corporate planner for buying and selling corporations that may have net operating loss deductions. In addition, this discussion includes all of the relevant changes made by the Tax Reform Act of 1976.

I. The General Concept of the Net Operating Loss Deduction

The Internal Revenue Code defines "net operating loss" as the excess of deductions over gross income for any taxable year.[1] A taxpayer may utilize a net operating loss deduction against taxable years and thereby receive a tax refund. In addition, any remaining net operating loss deduction qualifies as a "carryover" or offset against taxable income generated during a five-year period subsequent to the loss year.[2] Congress recognized the inherent unfairness

[1] I.R.C. § 172(c). In computing the net operating loss for a taxable year, no deduction is allowed for such items as another year's net operating loss, personal exemptions, § 1202 deductions, capital losses in excess of capital gains, and nonbusiness deductions of noncorporate taxpayers in excess of gross income. *Id.*

[2] *Id.* § 172(b)(1)(A),(B). The Tax Reform Act of 1976 extends the carryforward period to seven years (nine years for regulated transportation corporations). Also, the new Act allows the taxpayer to elect to forego the carryback treatment of net operating losses and only carry forward the net operating losses. This avoids the difficult computational tasks that would require the reconstruction of income tax returns of prior years. *Id. See also* A. Greenhill & A. Brown, Analysis and Text of the Tax Reform Act of 1976 at 16-17 (1976).

of taxing profitable years while at the same time allowing no benefits for loss years.[3] In the absence of the carryback and carryforward provisions, the taxpayer with relatively stable annual taxable income would have an advantage over the taxpayer with fluctuating taxable income and losses. In high income years the latter would be in a higher tax bracket, while in loss or no taxable income years, such a taxpayer would be without any offsetting tax benefit.

In addition to avoiding the inequity caused by a tax structure that varied with the type of business involved, Congress also intended to provide liquid funds to a once profitable taxpayer currently suffering net operating losses. This is accomplished by allowing the taxpayer who is suffering economic reverses to carry back current net operating losses and to offset them against his prior three years' taxable income. This results in a tax refund, the proceeds of which can be used to bolster the current operation.[4]

Prior to 1954, only section 269 of the Internal Revenue Code regulated acquisitions and reorganizations consummated to evade federal income tax.[5] In order to disallow a net operating loss deduction acquired by a profitable corporation from an unprofitable business, the Commissioner was required to prove that tax avoidance was the "primary purpose" of the acquisition. However, the acquiring corporation could usually demonstrate at least some degree of genuine business interest in the acquired corporation; therefore, the Commissioner rarely met the "primary purpose" proof barrier. The incentive to reduce taxable income by purchasing semi-related businesses with excessive net operating loss deductions was greatly increased.[6]

In 1954, Congress recognized that the existing law was "uncertain in its effects," and "placed a premium on litigation and a

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[3]H.R. REP. No. 1337, 83d Cong., 2d Sess. 27, *reprinted in* [1954] U.S. CODE CONG. & AD. NEWS 4017, 4052 [hereinafter cited as H.R. REP. No. 1337] states:

> The longer period for averaging will improve the equity of the tax system as between businesses with fluctuating income and those with comparatively stable incomes, and will be particularly helpful to the riskier types of enterprises which encounter marked variations in profitability. The additional year for the carryback also increases the liquid funds available for a business experiencing economic reverses.
>
> Your committee has also made changes . . . [i]n order to lessen the differences in tax treatment of firms with fluctuating and those with stable incomes.

[4]*Id.*

[5]I.R.C. § 269.

[6]*See, e.g.*, Mill Ridge Coal Co. v. Patterson, 264 F.2d 713 (5th Cir.), *cert. denied*, 361 U.S. 816 (1959). *See also* Gregory v. Helvering, 293 U.S. 465 (1935).

damper on valid business transactions."[7] In response to this problem, Congress promulgated special rules to govern net operating loss carryover and carryback provisions, to achieve the highest degree of objectivity possible and to thereby eliminate the uncertainty of section 269.[8] The 1954 Internal Revenue Code provided the mechanism for Congress to carry out such intent: section 382 specifically dealt with the availability of net operating loss carryovers in corporate purchase transactions. This section sets forth two objective limitations. The acquiring corporation's claim for the purchased net operating loss carryover will be disallowed only if both of the following limitations apply: (1) The acquired corporation's ten largest stockholders own fifty percentage points more of the acquiring corporation's outstanding stock after the acquisition than they had owned prior to the change in ownership (based on total fair market value),[9] and (2) the acquired corporation has not continued to

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[7]H.R. REP. NO. 1337, *supra* note 3, at 41-42. "This provision has proved ineffectual, however, because of the necessity of proving that avoidance was the primary purpose of the transaction. It has also been so uncertain in its effects as to place a premium on litigation and a damper on valid business transactions." *Id. See, e.g.*, Scroll, Inc. v. Comm'r, 447 F.2d 612 (5th Cir. 1971); Younker Bros. v. United States, 318 F. Supp. 202 (S.D. Iowa 1970); D'Arcy-MacManus & Masius, Inc. v. Comm'r, 63 T.C. 440 (1975); Stange Co. v. Comm'r, 36 T.C.M. (CCH) 31 (1977); Key Buick Co. v. Comm'r, 35 T.C.M. (CCH) 1359 (1976).

[8]H.R. REP. NO. 1337, *supra* note 3, at 42.

[9]I.R.C. § 382(a) (1954) (amended 1976). Section 382(a) states the following:

(a) Purchase of a Corporation and Change in Its Trade or Business.—

(1) In general.—If, at the end of a taxable year of a corporation—

(A) any one or more of those persons described in paragraph (2) own a percentage of the total fair market value of the outstanding stock of such corporation which is at least 50 percentage points more than such person or persons owned at—

(i) the beginning of such taxable year, or

(ii) the beginning of the prior taxable year,

(B) the increase in percentage points at the end of such taxable year is attributable to—

(i) a purchase by such person or persons of such stock, the stock of another corporation owning stock in such corporation, or an interest in a partnership or trust owning stock in such corporation, or

(ii) a decrease in the amount of such stock outstanding or the amount of stock outstanding of another corporation owning stock in such corporation, except a decrease resulting from a redemption to pay death taxes to which section 303 applies, and

(C) such corporation has not continued to carry on a trade or business substantially the same as that conducted before any change in the percentage ownership of the fair market value of such stock, the net operating loss carryovers, if any, from prior taxable years of such corporation to such taxable year and subsequent taxable years shall not be included in the net operating loss deduction for such taxable year and subsequent taxable years.

carry on a trade or business substantially the same as that conducted before any change in the percentage ownership of such stock.[10]

As Treasury regulation examples indicate, the fifty percentage point standard is primarily a mechanical and objective test.[11] In contrast, however, the continuity of business test has been a frequent source of litigation. The basic question is whether the acquiring corporation can utilize previously incurred net operation loss carryover benefits of the acquired corporation. This problem commonly arises when the acquired corporation operates a business entirely different from that of the acquiring corporation but is then changed after the purchase.[12]

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(2) Description of person or persons.—The person or persons referred to in paragraph (1) shall be the 10 persons (or such lesser number as there are persons owning the outstanding stock at the end of such taxable year) who own the greatest percentage of the fair market value of such stock at the end of such taxable year; except that, if any other person owns the same percentage of such stock at such time as is owned by one of the 10 persons, such person shall also be included. If any of the persons are so related that such stock owned by one is attributed to the other under the rules specified in paragraph (3), such person shall be considered as only one person solely for the purpose of selecting the 10 persons (more or less) who own the greatest percentage of the fair market value of such outstanding stock.

(3) Attribution of ownership.—Section 318 (relating to constructive ownership of stock) shall apply in determining the ownership of stock, except that sections 318(a)(2)(C) and 318(a)(3)(C) shall be applied without regard to the 50 percent limitation contained therein.

(4) Definition of purchase.—For purposes of this subsection, the term "purchase" means the acquisition of stock, the basis of which is determined solely by reference to its cost to the holder thereof, in a transaction from a person or persons other than the person or persons the ownership of whose stock would be attributed to the holder by application of paragraph (3).

[10]*Id.* § 382(a)(1)(C) (1954) (repealed 1976).

[11]*See* Treas. Reg. § 1.382(a)-1(d)(4), examples (1), (2) (1962).

[12]The Tax Reform Act of 1976 deletes the continuity of business requirement of § 382(a)(1)(C) for purchase transactions. Instead, only the change of ownership rule applies, which was increased to sixty as opposed to fifty percentage points, as under the 1954 version. Furthermore, if this ownership requirement is not met, the net operating loss carryover is not automatically disallowed. For each percentage point over sixty percent, the net operating loss is decreased by three and one-half percent. Above eighty percent, the rate of elimination is one and one-half percent per percentage point change. These provisions become effective after June 30, 1978 for stock purchases, and January 1, 1978 for tax-free reorganizations. I.R.C. § 382(a). *See also* A. GREENHILL & A. BROWN, ANALYSIS AND TEXT OF THE TAX REFORM ACT OF 1976 at 16-17 (1976); Myerson, Tax Reform Act of 1976. A Review for Business and Individuals, (1976) (Coopers & Lybrand Newsletter).

II. The Continuity of Business Test

A. *The Libson Shops Doctrine*

Example 1: On Jan. 15, 1975, *XYZ* Corporation, a metal hanger manufacturer, purchased Cola Corporation, a producer of soft drinks. Since 1972, Cola had experienced annual net operating losses, including the fiscal year that ended January 15, 1975. *XYZ*'s operations were historically profitable, and for the fiscal years ending January 15, 1976 and 1977, it experienced high profits and large taxable income.
Given: The transaction resulted in less than a fifty percentage points change in ownership.
Issue: Can *XYZ* apply Cola's pre-purchase net operating loss deduction as a carryover against its post-merger taxable income?

The Supreme Court in *Libson Shops, Inc. v. Koehler*[13] was presented with the issue of whether a corporation, resulting from the merger of seventeen separately incorporated businesses, could carry over and deduct pre-merger net operating losses, generated by three of the former entities, from the post-merger taxable income attributable to the other merged businesses. In disallowing the net operating loss carryover, the Court ruled that the taxable income against which the offset is claimed must be produced by substantially the same business that incurred the net operating losses.[14]

The narrow rule enunciated in *Libson Shops*, applied to the above example, would require that Cola Corporation, which generated the net operating loss, also generate the offsetting taxable income. Since only *XYZ* Corporation generated taxable income in *Example 1*, under the *Libson Shops* doctrine *XYZ* Corporation could not utilize Cola Corporation's net operating loss carryover incurred prior to the purchase.

Even though *Libson Shops* was decided in 1957, the Supreme Court based its decision on the 1939 Internal Revenue Code rather than the 1954 Code, which included section 382 and its special limitations. As previously mentioned, Congress intended that both the fifty percentage points test and the failure to carry on substantially the same business test apply before determining whether the net operating loss carryover would be disallowed.[15] *Example 1* did not fall within the fifty percentage points test; therefore, disallowance

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[13]353 U.S. 382 (1957).

[14]*Id.* at 390.

[15]I.R.C. § 382(a)(1)(A),(C). However, the continuity of business requirement will no longer apply to purchases occurring after June 30, 1978. *See* note 12 *supra.*

of *XYZ's* net operating loss deduction would have been improper. Even if *XYZ* had subsequently changed Cola's operations, disallowance would have been improper since both of section 382's limitations were not applicable.

Maxwell Hardware Co. v. Commissioner[16] emphasized that *Libson Shops* was decided under the 1939 Code, and that "by enacting the 1954 Code, Congress destroyed the precedential value" of the *Libson Shops* ruling that the taxable income against which offset is claimed must be produced by substantially the same business that incurred the net operating loss.[17] *Maxwell* allowed a taxpayer-corporation to carry over a net operating loss deduction incurred by a pre-merger hardware business and to offset such loss carryover against the taxable income generated by the taxpayer's post-merger real estate business. The merger transaction utilized an irrevocable voting trust device, which avoided the application of the fifty percentage points ownership limitation. The court noted, however, that the surviving entity, the real estate business, failed "to carry on substantially the same business or trade" as the hardware operation had conducted before any change in ownership. Nevertheless, only one of the section 382 limitations was met; therefore, the net operating loss carryover could not be disallowed. Similarly, in *Example 1, XYZ* may utilize Cola's net operating loss carryover deductions since only one of the section 382 tests applied, as *XYZ's* acquisition did not fall within the fifty percentage points barrier.[18]

Revenue Ruling 63-40 and Technical Information Release 777[19] also severely limit the effect of *Libson Shops*. The doctrine will now apply only when both the ownership and the acquired corporation's business change *after* the maximum two year period specified in section 382(a) has elapsed.[20] Another limited instance in which the *Libson Shops* doctrine will apply occurs when a single corporation discontinues a losing operation, purchases a profitable business, and undergoes a major change in stock ownership.[21]

B. Continuity of Business Involving Discontinued Operations

Example 2: *XYZ* Corporation operated three separate busi-

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[16]343 F.2d 713 (9th Cir. 1965).

[17]*Id.* at 716.

[18]Similarly, the only requirement of the Tax Reform Act of 1976—the 60 percentage points test—was not violated by the taxpayer in *Maxwell Hardware*. Therefore, the net operating loss carryover would be allowed. I.R.C. § 382(a).

[19]Rev. Rul. 63-40, 1963-1 C.B. 46; TIR 777, 1965-2 C.B. 53.

[20]Milefsky, Using Acquired Corporate Loss Carryovers, (1976) (Coopers & Lybrand Newsletter).

[21]*Id.*

nesses, *X*, *Y*, and *Z*: *X* processed dry goods, *Y* catered parties, and *Z* manufactured shoes. Each business contributed about twenty percent to *XYZ*'s total output and assets. In 1973, *XYZ* suffered substantial net operating losses, all attributable to *Z*. In January 1974, *ABC* Corporation purchased sixty percent of *XYZ*'s stock, but during the same month, *Z*'s operations were discontinued. *ABC* experienced substantial profits during the calendar year 1974.

Issue: Can *ABC* Corporation carry over the net operating loss attributable to *Z* for the year ending December 1974 even though *Z* was discontinued?

Example 3: In 1974, *P* Corporation, a profitable steel manufacturer, acquired *S* Corporation, a steel fabricator that had experienced net operating losses for many years. During the taxable year 1975, *P* discontinued one-half of *S*'s operations, which comprised twenty-two percent of *P*'s total assets. In 1975, *P* experienced large profits.

Issue: In 1975, can *P* deduct the net operating loss carryover arising from the discontinued activities of *S* corporation?

Treasury Regulation § 1.382(a)-1(b)(7) states that a corporation has not continued to carry on substantially the same business or trade as that conducted prior to an increase in ownership of the purchaser's stock if such corporation discontinues more than a "minor portion" of its business carried on before such increase. The proposed test to determine what constitutes a "minor" portion is to question whether "the discontinuance of the activities has the effect of utilizing loss carryovers to offset gains of a business *unrelated* to that which produced the losses."[22]

In *Coast Quality Construction Corp. v. United States*,[23] a residential real estate developer, after a series of stock transfers and mergers, reorganized his four former wholly-owned subsidiaries. One unprofitable subsidiary that comprised forty-four percent of the taxpayer's total assets was discontinued. The court ruled that in order to satisfy the substantially the same business test of section 382(a)(1)(c), it must be shown that any discontinued activities to which the net operating loss is attributable were related to the ongoing business and did not constitute more than a minor portion of the corporate taxpayer's business prior to the ownership change. The taxpayer was therefore allowed to deduct the net operating loss carryover even though the discontinued segment comprised forty-

[22]Treas. Reg. § 1.382(a)-1(h)(7) (1962) (emphasis added).

[23]463 F.2d 503 (5th Cir. 1972).

four percent of taxpayer's total assets, because all of the business activities were related to real estate development.[24]

Coast Quality demonstrates that percentage is less important than the qualitative relation between the wholly-owned subsidiaries in determining what constitutes a "minor" portion. Discontinuance of a segment of the acquired business does not result in a failure to carry on substantially the same business, provided the net operating loss carryover attributable to the discontinued segment is *not* used to offset the acquiring corporation's taxable income derived from a source wholly unrelated to the discontinued business.[25] In *Coast Quality*, all of the separate subsidiaries operated as real estate developers and employed the same number of people; hence, there were no distinguishing characteristics. They were not separate and unrelated economic units but were, in fact, closely related.

In *Example 3*, the partially discontinued *S* corporation comprised twenty-two percent of *P*'s total assets, which would appear to be only a minor activity since *Coast Quality* held that a forty-four percent segment was still within the "minor" range. However, this quantitative analysis alone is inadequate since it still must be determined whether the net operating loss carryover attributable to *S* offsets the taxable income of *P* that is related to the business that produced the net operating loss. Since both businesses relate to steel production, the discontinuance of only one-half of *S* most likely constituted a "minor portion." Therefore, *P* probably continued to carry on substantially the same business as it did at the time of the increase in ownership.

Even though the discontinued *Z* segment in *Example 2* included a lower percentage of total assets than the abandoned business in *Example 3*, it still fails to qualify as a "minor portion" of *XYZ*'s total operations. *Z* was not related to the ongoing business; it was a separate and distinct type of business and therefore failed to constitute a "minor portion." Since it was established that *Z* was a separate business, allowance of the net operating loss carryover deduction would have resulted in offsetting taxable income and net operating losses of wholly unrelated businesses (*Z* produced shoes, *Y* catered parties, and *X* processed dry goods). In comparison, the businesses in *Example 3* were not separate, for both were related to steel production.

Treasury Regulation § 1.382a-1(h)(5) requires that all facts and circumstances of a particular case be examined in determining whether a corporation has continued to carry on substantially the

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[24] *Id.* at 512.

[25] Treas. Reg. § 1.382(a)-1(h)(7) (1962).

same business. The analysis should particularly examine changes in corporate employees, plants, equipment, production, and location. Therefore, in both *Example 2* and *3*, these additional facts should be examined in order to accurately ascertain the degree of relation between the business segments.

The objective of net operating loss carryovers is to smooth out fluctuations that extend beyond the accounting periods of a business due to the tax accounting rules, rather than offset the taxable income of a business with another *unrelated* business' net operating loss carryover.[26] "In short, Congress did not want the net operating loss to be applicable if it was incurred by a different business."[27] The Senate explicitly provided that a discontinuance of any portion, except one which is "minor," would result in a failure to carry on substantially the same business.[28]

In *Glen Raven Mills, Inc. v. Commissioner*,[29] the principal operation of the acquired subsidiary, hosiery manufacturing, was entirely discontinued. Subsequent to the change in ownership the purchasing parent corporation implemented the production of flat fabric cloth in the newly-acquired subsidiary's plant. The court examined the factors set forth in Treasury Regulation § 1.382a-1(h)(5)[30] and concluded that from the viewpoint of a person in the knitting business, production of hosiery and flat fabric cloth are quite similar. The purchasing corporation was therefore allowed to carry over the previous incurred net operating loss deductions of the acquired subsidiary even though the latter's product line, which had incurred the loss, was completely discontinued. The court noted that even though the acquired subsidiary experienced a significant change in customers, the Commissioner had failed to prove how this altered or substantially changed the acquired corporation's business.[31]

The dissenting opinion in *Glen Raven* cited *Coast Quality* to support the proposition that the "substantially same business requirement of section 382(a) only permitted a minor or insubstantial change in the acquired corporation."[32] Therefore, a complete change

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[26]Coast Quality Constr. Co. v. United States, 463 F.2d 503, 509 (5th Cir. 1972) (citing Commissioner v. Barclay Jewelry, Inc., 367 F.2d 193, 196 (1st Cir. 1966)).

[27]*Id.*

[28]S. REP. NO. 1622, 83d Cong., 2d Sess. 285, *reprinted in* [1954] U.S. CODE CONG. & AD. NEWS 4924.

[29]59 T.C. 1 (1972).

[30]For example, the following factors are listed therein: changes in the acquiring corporation's employees, plant, equipment, production, location, and customers.

[31]I.R.C. § 382(a)(1)(C).

[32]59 T.C. at 18-21 (dissenting opinion) (citing Coast Quality Constr. Co. v. United States, 463 F.2d 503 (5th Cir. 1972)).

in product line and customers was outside this narrowly defined range. Furthermore, Congress did not contemplate the "unlimited or extensive changes" necessary to eliminate unprofitable operations when it required that the acquired business remain substantially the same.[33]

The four concurring judges in *Glen Raven* presented the most liberal interpretation of the substantially same business requirement of section 382(a):

> Congress intended for us to strike a balance between two oft-conflicting goals; one, the curtailment of trafficking in loss corporations and, two, the avoidance of any dampening effects on valid business transactions. Here the majority has found no "trafficking." I would also emphasize the potential "dampening effects." Because of the high degree of competition and the need for product diversification in the textile business, the key to success seems to be flexibility. The rather narrow, restrictive view expressed in the dissenting opinion would tie the hands of businessmen in this and similar businesses for as much as 2 years. That, in my judgment, would make section 382(a) the instrument of uneven justice.[34]

Glen Raven can be distinguished from *Example 2* and *3*, for in the latter situations, the discontinuance related to an entire business segment and not merely to a product line. *Glen Raven*, however, remains an important guide for those parent corporations desiring to change product lines of a subsidiary while still claiming the subsidiary's net operating loss carryover.

Finally, close attention must be directed to the type of industry involved in the particular transaction. For example, if the taxpayer in *Glen Raven* had been in a less competitive and less diversified product industry, perhaps a different construction of a "substantial change" in business would have been applied.[35]

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[33] *Id.* at 19 (Simpson, Raum and Quealy, JJ., dissenting opinion).

[34] *Id.* at 17 (Dawson, Drennen, Sterrett, and Goffe, JJ., concurring opinion). Section 382 requires the change of business to occur within a two year period of the change in ownership; therefore, an acquiring corporation could arguably avoid a disallowance in § 382 by purchasing a loss corporation, then waiting two years before changing the business. However, application of § 269 might disallow any deduction if the transaction's principal purpose is tax avoidance. Note that under the Tax Reform Act of 1976, the change of business requirement has been deleted and now the only relevant inquiry is whether there has been a significant change in ownership (a sixty percentage point change). For a discussion, *see* note 12 *supra*.

[35] *See id.* at 17 (Dawson, J., concurring opinion).

C. Continuity of Business Involving Dormant Operations

Example 4: *X* Corporation manufactured luggage. On January 1, 1975, *X* discontinued its operations due to its adverse financial position. On August 1, 1975, *B* Corporation purchased at least fifty percent of *X*'s stock. *X* remained dormant during the interim. On September 1, *B* revived *X*'s operations, changing, in part, the luggage design. In 1976, *B* experienced substantial profits, although the luggage business continued to lose money.
Issue: Can *B* utilize *X*'s previously incurred net operating loss carryovers for the fiscal year ending in January 1976?

In *Six Seam Co. v. United States*,[36] a mining company claimed a net operating loss carryover deduction arising from a formerly owned coal processing company. The processing company had suspended operations with intent to wind up its affairs just prior to the change in ownership. The court applied a treasury regulation[37] which disallows a net operating loss carryover if the acquired corporation is not carrying on an "active" trade or business at the time of the increase in ownership.[38] The problem remained, however, of determining the appropriate degree of activity necessary to sustain the characterization of "active trade or business." The court in *Six Seam* held the proper test to be whether there is an intent to "wind up" the business, or whether the corporation is simply maintaining a "low profile" with intention to resume operations upon a change in economic conditions.[39] Applying this rationale to *Example 4*, it is apparent that in order to avoid disallowance of the net operating loss carryover, *B* corporation must show that *X* corporation's nine month suspension of operations was due solely to economic conditions and not to an intent to wind up the corporate business.

In *Six Seam*, the Commissioner unsuccessfully argued that there had been a "substantial" change in business—from coal processing to coal mining—regardless of the discontinuance issue. Relying on *Frederick Steel Co. v. Commissioner*,[40] the court held that change in ownership and change in business must occur in the same year to warrant disallowance of the net operating loss carryover deduction. The change of business in *Six Seam* occurred in 1963, whereas the

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[36]524 F.2d 347 (6th Cir. 1975).

[37]Treas. Reg. § 1.382(a)-1(h)(6) (1962).

[38]Hence, if this "active" requirement is not met, the taxpayer's acquired corporation will be deemed not to have carried on substantially the same business as carried on prior to the increase in ownership.

[39]524 F.2d at 354.

[40]375 F.2d 351, 354 (6th Cir.), *cert. denied*, 389 U.S. 901 (1967).

change in ownership occurred in 1961; therefore, the substantial business test was not in issue because of this two year time lag. If there had not been a discontinuance, the Commissioner would have been required to allow the taxpayer's net operating loss carryover. Similarly, section 382 requires that the change of ownership be measured either in the prior taxable year or at the beginning of the taxable year in which the deduction is sought,[41] but not within the prior two years, as the Commissioner argued in *Six Seam*.[42]

Arguably, a taxpayer could avoid the application of section 382(a) by acquiring a loss corporation that has a different type of business and by maintaining its operations at a low level for two years.[43] After this period the acquiring corporation could change the loss corporation's business substantially and still utilize the net operating loss carryover. This would have been the situation in *Six Seam* in the absence of the inactive period. However, two major problems are involved in such a scheme: (1) The economic realities of allowing large capital investments to remain idle for a two year period may cost more than the benefits derived from the allowable net operating loss carryovers,[44] and (2) section 269 disallows any tax benefits resulting from an acquisition if tax avoidance was the principal purpose of such scheme.[45]

The underlying rationale of the rule disallowing the net operating loss carryover deductions of a business temporarily suspended prior to a change in ownership has been addressed by many courts.[46] Profits arising from revived operations do not fall within the same accounting period as losses attributable to the pre-revival business. Furthermore, even if customers, employees, product, and location remain the same, there is still a new endeavor. "In effect, [the

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[41]I.R.C. § 382(a)(1)(A)(i),(ii) (1954) (amended 1976).

[42]Note that the Tax Reform Act of 1976, in deleting the continuity of business test and requiring only a continuity of ownership test (sixty percentage points), utilizes a three year period in which stock is purchased or exchanged as opposed to the aforementioned two year limit. *See* note 13 *supra*. Therefore, under the new law, one could possibly avoid the invocation of the sixty percentage points ownership barrier by spreading the purchase agreement over a period greater than three years. However, if the principal purpose of this transaction was tax avoidance, then § 269 would disallow related deductions.

[43]That is, maintain the corporation's operations at a level that would not constitute what Treas. Reg. § 1.382(a)-1(h)(6) (1962) defines as an "inactive" level of operation.

[44]*See* McGaffey, *Utilization of Net Operating Losses*, 51 TAXES 613, 616 (1973). "The relatively short period of a year and a fraction can be justified on the ground that it is unlikely that the operation will be continued this length of time if the tax avoidance is the sole reason for the acquisition." *Id.*

[45]I.R.C. § 269(a).

[46]*See, e.g.*, S.F.H., Inc. v. Comm'r, 444 F.2d 139 (3d Cir. 1971).

business] has taken its losses, given up, had a change of mind, and begun afresh."[47] As previously mentioned, these suspension situations must be distinguished from those cases in which economic conditions alone require a slowdown of operations and there is no intent to wind up corporate affairs.[48]

The court in *Glover Packing Co. v. United States*[49] recognized that even though a business is temporarily suspended prior to a change in ownership, a suspension does not automatically require a failure of the "continuity of business" test set forth in section 382 (a)(1)(c). The original Senate Finance Committee draft of the "continuity of business" test required that the acquired corporation "carry on a trade or business substantially the same as that conducted *immediately* before any change in the percentage ownership."[50] However, the Committee deleted the word "immediately" from the final report;[51] therefore, an apparent tolerable break in the continuity requirement exists, as illustrated by the following Treasury example. If prior to the merger the acquired corporation experiences a devastating fire that halts normal operations for a temporary period preceding the increase in ownership, this, in itself, does not constitute a failure to carry on substantially the same business.[52] In contrast, the taxpayer in *Glover* allowed his meatpacking facilities to remain idle for five years prior to the change in ownership. Therefore, the net operating loss carryover was properly disallowed in accordance with the Treasury's interpretation of section 382(a).[53]

D. Continuity of Business Involving Trading of Securities

Example 5: *X* Corporation, a drug retailer, suffered heavy losses during 1971, 1972, and 1973. In late 1973, *X* discontinued its drug retail business and used the proceeds from liquidation to purchase United States Government Securities. From the trading of these securities, *X* realized taxable income in 1974 and 1975 and applied part of its net operating loss carryover deductions to both years. On January 1, 1976, *Z* Investment Corporation, a brokerage firm, purchased *X* Corporation and continued its business investments.
Issue: Can *Z* Investment Corporation utilize *X*'s net opera-

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[47]Coast Quality Constr. Corp. v. United States, 463 F.2d 503, 510 (5th Cir. 1972).
[48]Clarksdale Rubber Co. v. Comm'r, 45 T.C. 234 (1965).
[49]328 F.2d 342 (Ct. Cl. 1964).
[50]*Id.* at 348 (emphasis added).
[51]*Id.*
[52]Treas. Reg. § 1.382(a)-(h)(6), example 2 (1962).
[53]*See also* United States v. Fenix & Scisson, Inc., 360 F.2d 260 (10th Cir. 1966).

ting loss carryovers against the combined income of *Z* and *X* for the year ending December 31, 1976?

Excel Corp. v. United States[54] reaffirmed *Maxwell Hardware*, which had held that loss-producing businesses need not be continued, nor must the net operating loss carryover offset the taxable income produced by the loss-incurring business as long as the surviving corporation continues to carry on substantially the same business.[55] In *Excel*, the taxpayer, who was in the investment business, purchased a newly-formed investment company that previously had been an unprofitable retail lumber company. Because an investment business was present prior to the change in ownership, the taxpayer argued that the continuity test of section 382(a) had been met and therefore the net operating loss incurred by the old lumber business should have been allowed as a net operating loss carryover deduction. The court, however, relying on Treasury Regulation § 1.382a-1 (h)(4), rejected this argument. This regulation states that the holding, purchase, or sale of stock or securities for investment purposes shall not be considered a trade or business unless such activities have historically constituted the corporation's primary activities. Thus, the taxpayer's claimed investment activities prior to change in ownership were considered nonexistent. The court concluded that retail lumber, as compared to the post-ownership investment activities, constituted a substantial change in business.

Excel applied Treasury Regulation § 1.382a-1(h)(4) even though it was promulgated *after* the occurrence of the controverted activity. The court held that Treasury regulations must be applied, even retroactively, "unless they are unreasonable and plainly inconsistent with the revenue statutes. . . ."[56] Based upon the above conclusions, in *Example 5*, *Z* Investment Corporation would not be able to utilize *X*'s net operating loss.

E. Continuity of Business Test—In Contemplation of an Ownership Change

Example 6: *S* Corporation, a manufacturer of infants' garments, suffered substantial net operating losses in the last five years. *S* is located in a city which has many travel trailer manufacturers. In 1972, *S* decided to terminate its in-

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[54]451 F.2d 80 (8th Cir. 1971).

[55]343 F.2d at 722-23. *See also* notes 16-17 *supra* and accompanying text. However, any discontinuance may only be a "minor" portion of taxpayer's business, as *Examples 2* and *3* have demonstrated.

[56]451 F.2d at 85 (citing Commissioner v. South Texas Lumber Co., 333 U.S. 496, 501 (1948)).

fant clothing line and switch to manufacturing upholstery material for local travel trailer manufacturers. This operation also was unprofitable, so in 1974, *S* sold its operations to Bigline Trailer Manufacturers, Inc., which intended to use *S* as its exclusive upholstery source.
Issue: Can Bigline use the net operating loss deductions incurred by *S* corporation prior to its change in product line?

The Commissioner denies net operating loss carryover deductions only when there is a substantial change in business of the acquired corporation after a change in ownership.[57] Treasury Regulation § 1.382(a)-1(h)(3), however, provides that if a substantial change in business or trade is made by the acquired corporation in contemplation of a change in stock ownership, any resulting net operating loss carryover deductions will be disallowed. The critical issue in *Example 6*, therefore, is whether *S* made the change in product line in contemplation of a purchase by Bigline Trailer. If Bigline Trailer initiated the scheme and the change was merely to avoid the continuity of business requirement of section 382(a), then the net operating loss carryover would not be allowed. Note that if Bigline had acquired *S* prior to any change in business and then switched the product line from infants' clothing to upholstery cloth, such a change would have resulted in a break of the continuity of the loss corporation's business.[58]

F. Continuity of Business Test—Relocation of Facilities

Example 7: Book Corporation manufactured bookends in State *X* and sustained net operating losses in the past three years. In 1970, Volume Corporation purchased eighty percent of Book's outstanding stock. In early 1971, Book moved its operations to State *Z*, 800 miles away. In the process Book sold its plant and fixtures in State *X*, and built a new plant and hired new employees in State *Z*. However, Book still sold to the same customers.
Issue: Can Volume Corporation utilize Book's pre-merger net operating loss carryover against its taxable income for the year ending December 31, 1971?

A loss corporation has not continued to carry on substantially the same trade or business as that conducted before an increase in

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[57]I.R.C. § 382(a)(1)(C).

[58]In that instance § 382(a)(1) of the 1954 Code would have been applied to disallow the loss carryover if the fifty percentage points test of § 382(a)(1)(A) was also met. However, the Tax Reform Act of 1976 would render the continuity of business issue irrelevant, and only the ownership test would be in issue. For further discussion, *see* note 12 *supra*.

ownership if the corporation changes the location of a "major portion of its activities, and as a result of such change in location of the business" is substantially altered.[59] The Book Corporation continued to manufacture the same product and retained the same customers. However, as a result of changing the location of its operations, the construction of a new physical plant with the installation of new plant fixtures was required. In addition, new employees were hired. Therefore, a substantial change in the business of the loss corporation occurred. If there was also an increase of fifty percentage points in ownership, the net operating loss carryover would be disallowed.[60] In contrast, if Book Corporation had only relocated to the nearby city and, except for a change in production facilities, retained the same business, there would not have been a substantial change in business.[61]

III. Utilizing Net Operating Loss Carryforwards in Tax-Free Reorganizations

Example 8: On January 1, 1973, by way of a statutory merger under section 368(a)(1)(A),[62] *AB* and *CD* Corporations merged into *ABCD* Corporation. Prior to this merger, *CD* had suffered heavy financial losses for the year ending December 31, 1972, and had available a $50,000 net operating loss carryover. *CD*'s shareholders were given 1500 shares of *ABCD* Corporation, which had a total of 15,000 shares outstanding at $100 par value. In 1973, *ABCD* earned $100,000. *Issue:* Can *ABCD* utilize the net operating loss deduction carryover arising from *CD*'s operations, and if so, to what extent?

In a tax-free reorganization, section 382(b)(1) explicitly requires that the stockholders of the transferor corporation maintain at least a twenty-percent interest in the fair market value of the outstanding shares of the acquiring corporation.[63] So in *Example 8*, since the

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[59]Treas. Reg. § 1.382(a)-1(h)(9) (1962).

[60]I.R.C. § 382(a)(1)(A),(C).

[61]*See* Treas. Reg. § 1.382(a)-1(h)(9), examples (1),(2) (1962).

[62]Commonly termed an "A" type statute merger.

[63]This limitation only applies to "A," "C," "D," or "F" type reorganizations. I.R.C. § 382(b)(1) (1954) (amended 1976). Section 382(b)(1) states the following:

(b) Change of Ownership as the Result of a Reorganization.—

(1) In general.—If, in the case of a reorganization specified in paragraph (2) of section 381(a), the transferor corporation or the acquiring corporation—

(A) has a net operating loss which is a net operating loss carry-over to the first taxable year of the acquiring corporation ending after the date of transfer, and

(B) the stockholders (immediately before the reorganization) of such cor-

fair market value of the stock held by the transferor shareholders was less than twenty percent of the fair market value of the acquiring corporation's (*ABCD*) outstanding stock,[64] a reduction of the net operating loss carryover is required. *CD* shareholders own 1500 shares, or only 1/10 of the total outstanding shares. The amount of this deduction is determined by multiplying the percentage of the acquired or transferor's shareholders' ownership by 5, and then subtracting this product from 100.[65] Through this procedure, the $50,000 loss carryover in *Example 8* would be reduced by one-half,[66] to $25,000.

If *both* the transferor and the acquiring corporation are substantially owned by the same person and in the same proportion, then the twenty-percent limitation will not apply in a tax-free reorganiza-

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poration (hereinafter in this subsection referred to as the "loss corporation"), as the result of owning stock of the loss corporation, own (immediately after the reorganization) less than 20 per cent of the fair market value of the outstanding stock of the acquiring corporation,

the total net operating loss carryover from prior taxable years of the loss corporation to the first taxable year of the acquiring corporation ending after the date of transfer shall be reduced by the percentage determined under paragraph (2).

Note that the Tax Reform Act of 1976 extends this limitation to "B" type reorganizations. *Id.*

In addition, I.R.C. § 381(a) states the following:

(a) General Rule.—In the case of the acquisition of assets of a corporation by another corporation—

(1) in a distribution to such other corporation to which section 332 (relating to liquidations of subsidiaries) applies, except in a case in which the basis of the assets distributed is determined under section 334(b)(2); or

(2) in a transfer to which section 361 (relating to nonrecognition of gain or loss to corporations) applies, but only if the transfer is in connection with a reorganization described in subparagraph (A), (C), (D) (but only if the requirements or subparagraphs (A) and (B) of section 354(b)(1) are met), or (F) of section 368(a)(1),

the acquiring corporation shall succeed to and take into account, as of the close of the day of distribution or transfer, the items described in subsection (c) of the distributor or transferor corporation, subject to the conditions and limitations specified in subsections (b) and (c).

[64] *CD* shareholders own 1500 shares or only 10% of the total outstanding shares.

[65] I.R.C. § 382(b)(2) (1954) (amended 1976). Section 382(a)(2) states the following:

(2) Reduction of Net Operating Loss Carryover.—The reduction applicable under paragraph (1) shall be the percentage determined by subtracting from 100 percent—

(A) the percent of the fair market value of the outstanding stock of the acquiring corporation owned (immediately after the reorganization) by the stockholders (immediately before the reorganization) of the loss corporation, as the result of owning stock of the loss corporation, multiplied by

(B) five.

[66] 5x10% = 50%; 100% - 50% = 50%.

tion.[67] In *Commonwealth Container Corp. v. Commissioner*,[68] the court allowed the acquiring corporation to deduct only sixty-five percent of the total net operating loss carryover, since prior to the merger there was a shareholder who owned twenty-five percent of the acquiring corporation but had no interest in the transferor corporation.

The Treasury explains that determining if the net operating loss of a corporation involved in a tax-free reorganization will be allowed in full depends on whether the shareholders of the loss corporation have a "substantial continuing interest"[69] in the acquiring corporation. This assures that those who have incurred the net operating loss will benefit to some extent from the related net operating loss carryovers,[70] and coincides with the legislative intent that section 382 should forbid the "trafficking" of net operating losses to parties who are unrelated to the loss corporation.[71]

Note that in *Examples 1* through *6* the transaction involved stock purchases, whereas *Example 7* utilized a tax-free reorganization. In the former instances, both the continuity of ownership and business requirements set forth in section 382(a) are controlling, while in the latter situation, only the "twenty-percent" rule limits the availability of the net operating loss carryovers. Instead of a similar "gradual" reduction, section 382(a) imposes an all or nothing concept in stock purchases. If the continuity requirements are not met, then the entire net operating loss carryover is disallowed.

The Tax Reform Act of 1976[72] removes this disparity by imposing parallel limitations on both purchases and tax-free reorganizations. The new Act establishes a gradual reduction of net operating loss carryovers for both purchases and reorganizations based on ownership requirements only. The continuity of business test for stock purchases has been repealed.[73]

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[67]I.R.C. § 382(b)(6)(A).

[68]393 F.2d 269 (3rd Cir. 1968).

[69]Treas. Reg. § 1.382(b)-1(c)(1) (1962).

[70]*Id.*

[71]H.R. REP. No. 1337, *supra* note 7, at 22.

[72]Tax Reform Act of 1976, Pub. L. No. 94-455, § 806, 90 Stat. 1520 (approved October 4, 1976).

[73]For purchases under the new law, there is no elimination of net operating losses unless there is an increase in ownership of sixty percentage points. Moreover, net operating losses are eliminated at the rate of three and one-half percent per one percentage point change if the ownership change is from sixty percent to eighty percent. The rate of elimination is one and one-half percent per percentage point change above eighty percent. This rule goes into effect for taxable years of the net operating loss corporation beginning after June 30, 1978.

For tax-free reorganizations, losses are eliminated when the transferor shareholders own less than forty percent—as opposed to twenty percent under prior

IV. The Net Operating Loss Carryback Rule in General

Whether post-merger net operating losses generated by the purchasing corporation can be offset or "carried back" against the pre-merger income of the acquired corporation is another question facing corporate planners. The examples below present common problems in this area.

> *Example 9:* On January 1, 1974, *X* Corporation merged with *Y* Corporation pursuant to a merger agreement executed December 15, 1973. *X* had experienced net operating taxable income in the past three years. For the year ending December 31, 1974, *Y* suffered substantial net operating losses.
> *Issue:* May the newly merged corporation, *XY*, carry back the net operating losses generated by *Y* to offset the pre-merger taxable income of *X* and thereby receive a tax refund for the three previous years?

The Internal Revenue Code forbids the acquiring corporation to carry back a net operating loss generated *after* the date of transfer to a pre-merger taxable year of the transferor (acquired) corporation.[74] Therefore, in *Example 9*, *XY* could not carry back the net operating loss generated by *Y* to offset the pre-merger income of *X*.

In one narrow setting, however, the Code does allow the utilization of net operating loss carryback benefits after a corporate reorganization. The reorganization must be an "F" type, which is usually defined as a "mere change in identity, form, or place of organization."[75] Whether a reorganization qualifies as a "F" type has been a frequent issue in tax court litigation, and the results of such cases have usually caused more confusion than consistency.[76]

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law, § 382(b)—of the surviving entity. Elimination of net operating losses occurs at the rate of three and one-half percent for each percentage point below forty percent, and one and one-half percent for each percentage point below twenty percent. This rule becomes effective for plans adopted after January 1, 1978. I.R.C. § 382(a),(b).

[74]I.R.C. § 381(b)(3). *See* discussion in note 2 *supra* concerning the election available to the taxpayer under the Tax Reform Act of 1976 that permits an immediate deduction for a net operating loss carryforward in lieu of the three year net operating loss carryback.

[75]I.R.C. § 368(a)(1)(F). For other discussions, *see* Ranzal, *The F Reorganization: How It Can Be Used to Advantage to Combine Multiple Corporations*, 36 J. of Tax. 168 (1972); *see also* Pugh, *The F Reorganization: Reveille for a Sleeping Giant?* 24 Tax. L. Rev. 437 (1969); Osterberg, *Expansion of the (F) Reorganization*, 27 S.W. L. J. 251,267 (1973).

[76]Congress, in enacting the 1976 Tax Reform Act, did not amend or repeal any net operating loss carryback rules in § 381, but only dealt with the previously discussed net operating loss carryover rules.

In an attempt to solve this problem, Revenue Ruling 75-561 was issued, which states in part:

> (1) Given the combination of two or more commonly owned operating corporations or the merger of two wholly owned subsidiaries, an "F" reorganization will occur so long as (a) there is a complete identity of shareholders and their proprietary interests in the tranferor and acquiring corporations, (b) the acquiring and transferor corporation are in the same business or integrated activity prior to combination, and (c) the business enterprise of the two entities continues unchanged after the combination; and
>
> (2) an acquiring corporation that qualifies as an "F" type and desires to carry back the transferor's post-merger net operating losses to the transferor's pre-merger taxable income under section 381(b)(3) must further show (a) net operating losses are attributable to a separate business or division formerly operated by the transferor corporation, and (b) that the transferor corporation has taxable income in its pre-merger taxable years to offset the net operating loss carryback.[77]

The effect of this Ruling is to present two major barriers to the corporate planner advising on a reorganization that has potential net operating losses: (1) The planner must determine whether the reorganization qualifies as an "F" type; and (2) the planner must decide whether the post-merger net operating losses, if likely to arise, are "attributable" to separate divisions of the transferor corporation. As the examples presented below indicate, Revenue Ruling 75-561 will hereafter provide corporate planners and the courts with objective guidelines to reorganization planning and litigation in most instances.

A. The Net Operating Loss Carryback "Attribution" Rule

> *Example 10:* *A*, *B*, and *C* Corporations are all owned by Golden. A merger agreement is drafted and signed on December 31, 1974; the new entity is *ABC* Corporation. For the year ending December 31, 1975, *ABC* suffered a $100,000 net operating loss: $60,000 was attributable to *A*, and $40,000 to *B*. *C* reported no losses or taxable income.

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[77]Rev. Rul. 75-561, 1975-2 C.B. 129.

For the three years prior to the merger, the three divisions had the following taxable incomes:

	A	*B*	*C*
1974	$10,000	0	$50,000
1973	$20,000	0	$50,000
1972	$20,000	$10,000	$50,000

Issue: Assuming Golden's reorganization qualifies as an "F" type, is the entire $100,000 net operating loss available for carryback treatment?

ABC Corporation could carry back only $50,000 of the $60,000 net operating loss attributable to division *A* and only $10,000 of the $40,000 net operating loss attributable to *B*. Even though *C* had pre-merger taxable income available to offset the net operating loss carryback, Revenue Ruling 75-561 requires that such a loss be attributable to the same division that previously generated the taxable income.[78] Hence *C* did not qualify for a net operating loss carryback since it generated *no* net operating losses in 1975.

Unlike the conclusion reached in *Example 9*, the court in *Associated Machine v. Commissioner*[79] allowed the carryback of the post-merger net operating loss generated by the acquiring corporation to offset the transferor's pre-merger taxable income without limitation or "attribution," as required by Revenue Ruling 75-561. The taxpayer in *Associated Machine* owned both corporations prior to merger; one corporation was an engineering firm and the other a machine shop that processed the former's designs. The Commissioner incorrectly interpreted section 381 to allow only the offsetting of the transferor's pre-merger net operating loss against the acquiring corporation's pre-merger taxable income.[80] The court rejected this interpretation, holding that such a "simultaneous" offsetting of taxable income and net operating loss was without "logic or authority."[81] The court noted that Congress intended a sequential application of the net operating loss carryback concept[82] that would allow offsetting of post-merger net operating losses against pre-merger taxable income, but would never allow the offsetting of pre-merger figures alone.

Strangely enough, the same court, on the same day, expressly limited the amount of the available net operating loss carryback in deciding a different case having similar facts. In *Estate of Stauffer*

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[78] *Id.*
[79] 403 F.2d 622 (9th Cir. 1968).
[80] *Id.* at 625.
[81] *Id.*
[82] I.R.C. § 172(a).

v. Commissioner,[83] the taxpayer owned three similar retailing operations: one in New York, one in Illinois, and one in California. Pursuant to a merger agreement, these three businesses were to be reorganized in New Mexico. However, the relocation never occurred because all three businesses suffered financial losses caused by a drop in retail consumer demand. The court allowed the net operating loss carryback only to the extent that the post-merger net operating loss was attributable to an entity that had pre-merger taxable income available for offset.[84]

Reconciling the holdings of *Associated Machine* and *Stauffer* is not an easy task. *Associated Machine* may have mistakenly omitted the "attribution" limit mandated in *Stauffer*. Or perhaps the court placed significance on the fact that the businesses in *Associated Machine* were of the "brother-sister" type as opposed to the "parent-subsidiary" relation presented in *Stauffer*. Finally, the court may have felt the necessity of providing the "attribution" limitation for the closely-related California operations in *Associated Machine* was not as great as the necessity of providing the "attribution" limits for the three interstate corporations in *Stauffer*, which operated almost autonomously. In any event, the *Stauffer* rule is controlling in view of the "attribution" clause set forth in Revenue Ruling 75-561.

More recently, in *Home Construction Corp. of America v. United States*,[85] the court held that only such portion of the net operating loss as could be shown to be attributable to each of the former separate entities presently within the new organization could be carried back. In *Home Construction*, there had been a merger of 123 commonly owned corporations into a single legal entity.[86] The court emphasized that the "after-merger taxpayer may not obtain any more favorable treatment than it would have received had the loss occurred under the business' pre-merger form."[87]

In effect, *Home Construction* applied the strict "attribution" limitation, which requires that the post-merger entity generating the net operating loss have pre-merger taxable income available to offset the carryback.[88] In support of this application the court cited

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[83]403 F.2d 611 (9th Cir. 1971).

[84]*Id.* at 621-22.

[85]439 F.2d 1165 (5th Cir. 1971).

[86]This constituted an "F" type reorganization in that the only change was in simplification of bookkeeping; it was merely a "matter of form."

[87]439 F.2d at 1172.

[88]This is similar to the requirement that the post merger net operating loss be attributable to a pre-merger entity that had previously generaged income available for offset. Rev. Rul. 75-561, 1975-2 C.B. 129.

the rule of *Libson Shops*: net operating loss carrybacks may only be utilized if the net operating loss of the new corporation can be "reunited for the sake of tax accountability into the same taxable units which existed *before* reorganization."[89] This policy coincides with Revenue Ruling 75-561 in that the newly-reorganized corporation will not be allowed to reap the tax benefits of net operating loss carrybacks unless it can prove that such benefits would have been derived even if reorganization had not occurred. This net operating loss carryback policy is analogous to the accounting principle of proper "matching" of revenue and expenses incurred in the same period[90] in that Revenue Ruling 75-561 allows only a limited "matching" of post-merger income with pre-merger income once the strict "attribution" barrier is overcome.

B. The General Nature of an "F" Type Reorganization

Example 11: *P* Corporation, a manufacturer of baseball gloves, owned *S* Corporation, a profitable subsidiary that processed leather. Pursuant to an agreement dated January 1, 1974, *S* was merged into *P*, but there were no personnel or production changes. For the year ending January 15, 1975, *P* incurred a net operating loss, caused partially by the operation of *S*.
Issue: Can an "F" type reorganization include more than one "active" operating corporation and still constitute only a mere change in identity or form?

In *Movielab, Inc. v. United States*,[91] a parent corporation that processed black and white film merged with its wholly owned subsidiary, a processor of color film. The Commissioner disallowed the post-merger net operating loss carryback to the subsidiary's pre-merger taxable income. The Commissioner argued that the merger failed as an "F" type reorganization and therefore, section 381 barred any net operating loss carryback.[92] In addition, the Commissioner asserted that because of the restrictive language of an "F" type reorganization, which by definition only includes a "mere change in identity, form, or place of organization,"[93] only reorganizations involving one "active" operating corporation and one "shell," or non-operating entity, would qualify as an "F" type.[94]

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[89]439 F.2d at 1172 (citing Libson Shops, Inc. v. Koehler, 353 U.S. 382, 388-90 (1957)).

[90]*See* E. HENDRIKSEN, ACCOUNTING THEORY 183-84 (1970).

[91]494 F.2d 693 (Ct. Cl. 1974).

[92]*Id.* at 696; I.R.C. § 381(b)(3).

[93]494 F.2d at 696; I.R.C. § 368(a)(1)(F).

[94]494 F.2d at 696-97.

The court rejected this one "active" operating corporation argument, noting that in allowing an "F" type reorganization, Congress permitted reorganizations that were only a matter of form as opposed to a matter of substance.[95] Thus, so long as the reorganization was within this definition, the fact that the transaction involved more than one active corporation was irrelevant. Finally, the court held that there must be a complete identity of ownership between the merging entities, and a continuation of the same business without interruption;[96] these are the same elements that Revenue Ruling 75-561 requires.[97] Therefore, in *Example 11*, the merger of the two wholly-owned "active" corporations would not in itself bar a finding that such merger was an "F" type.[98]

Citing *Associated Machine*, *Stauffer*, and *Home Construction*, the court in *Movielab* reasoned that the basic concept surrounding the "F" type reorganization was that the new corporation is actually the "alter ego" of the former and constitutes a mere change in form.[99] Finally, the court stated that an "F" type reorganization could simultaneously qualify as a second type of reorganization specified by section 368(a)(1).[100]

Performance Systems, Inc. v. United States[101] was decided on the same basis as *Movielab*. The court, in allowing the carryback of the post-merger net operating loss to the transferor's pre-merger taxable income, held that the transaction was a matter of form only; therefore, it fell within the section 381(b) exception for an "F" type reorganization.[102] Furthermore, the district court recognized that a reorganization may qualify under several sub-sections of section 368 and still qualify as an "F" type.[103]

C. *A Matter of Form Versus a Matter of Substance*

Example 12: Jones owned ten separate Corporations. Each was located in a different city, produced the same product, and had separate management. In order to centralize bookkeeping and to utilize managerial specialization, Jones merged all ten corporations into one corporation called "Jones, Inc.," located in California. In the process, two corporations were

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[95] *Id.* at 697-98.

[96] *Id.* at 699.

[97] Rev. Rul. 75-561, 1975-2 C.B. 129.

[98] However, the attribution test illustrated by *Example 10* still must be met in order to utilize one hundred percent of the net operating loss carryback.

[99] 494 F.2d at 697.

[100] *Id.* at 700.

[101] 382 F. Supp. 525 (M.D. Tenn. 1973), *aff'd*, 501 F.2d 1338 (6th Cir. 1974).

[102] 382 F. Supp. at 533-34.

[103] *Id.* at 533 (acquiesced in Rev. Rul. 57-276, 1957-1 C.B. 126-128).

relocated to the new California headquarters, while the other eight remained in the same locations. The following year Jones, Inc. suffered heavy financial losses and desired to carry back these losses against the pre-merger taxable income of the "attributable"[104] former subsidiaries.
Issue: Is the reorganization still only a matter of form, thereby qualifying as an "F" type reorganization, or is it a matter of substance because of the relocation of two of the subsidiaries?

The basic problem is determining the exact point at which a matter of "form" becomes one of substance in regard to a reorganization of the type represented in *Example 12.* The courts, in addition to examining whether there has been an uninterrupted continuation of business and ownership interest, also examine another key factor: the purpose of the business transaction. In *Movielab,* the court concluded that the purpose of the merger was merely to simplify bookkeeping and administration since all other factors, such as personnel, product, and location, remained the same.[105] In *Home Construction,* the Commissioner argued that a reorganization which alters the number of taxable entities—in this case from 123 to 1—could never qualify as an "F" type reorganization because of the varying tax effect.[106] Therefore, any reorganization which changed the tax results of an entity could not be considered a "mere change in form," but one in substance only.[107] The court rejected this reasoning and held that tax results cannot form even "a partial measure of determining what substance is present in a transaction. . . . [T]he government's position would literally let the tail wag the dog."[108] *Stauffer* adopted the concept enunciated in *Davant v. Commissioner*[109] concerning "F" type reorganizations. *Davant* held that a shift of the operating assets from the transferor corporation to its alter ego, given complete identity of proprietary interests and continuity of business enterprise, results in an "F" type reorganization.[110]

In *Example 12,* the major objectives of Jones, Inc. were to simplify bookkeeping and to attain a higher degree of managerial specialization. These goals appear to be within the permissive limits

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[104] *See* the discussion of the attribution clause of Rev. Rul. 75-561, 1975-2 C.B. 129 at notes 78-91 *supra* and accompanying text.

[105] 494 F.2d at 693.

[106] 439 F.2d at 1170.

[107] *Id.*

[108] *Id.*

[109] 366 F.2d 874 (5th Cir. 1966), *cert. denied,* 386 U.S. 1022 (1967).

[110] *Id.* at 884.

of what constitutes an "F" type reorganization. However, the relocation of two businesses could possibly alter this characterization in favor of it being a matter of substance. In *Stauffer*, the court noted in dictum that if the pre-merger operations had been physically relocated from New York, Illinois, and California, to New Mexico, thus forming a single operation, there would have been "no means by which a loss could be pro-rated among the pre-merger identities."[111] In other words, if there had been a relocation that resulted in the combining of all three formerly separate operations, then the "attribution" test[112] would be impossible to satisfy since the total losses of the combined unit would not be subject to an easy demarcation. The relocation of only two subsidiaries, however, provided they remained segregated, probably would not cause such a problem, since it would still be possible to determine each division's corresponding net operating loss. However, if the ten subsidiaries in *Example 12* were all relocated and integrated at the new headquarters, such division or "attribution" of each division's corresponding net operating loss would be practically impossible.

The rationale underlying an "F" type reorganization is that the transaction involves merely a change in corporate structure and not a break in the continuity of ownership and business of the enterprise. Thus, a tax-free status is achieved via the reorganization. In contrast, a change in ownership, or even a slight shift of the proprietary interests, would not result in a tax-free merger, but rather a "sale"; such a transaction becomes one of substance. In addition, a liquidation of assets would result in taxable income since this also would constitute a matter of substance.[113] The Senate intended that such decisions pertaining to form or substance be based on "economic realities" rather than "artificialities."[114] A close analysis of the entire reorganization is therefore necessary to determine whether there has been more than a mere change in form. A finding that the reorganization is more than a change in form results in a loss of tax-free status in addition to a disallowance of the claimed net operating loss carryback.

Eastern Color Printing v. Commissioner[115] reaffirmed the proposition that a mere change in form, even though involving two active corporations, qualifies as an "F" type reorganization. In *Eastern*

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[111]403 F.2d at 622.

[112]*See* Rev. Rul. 75-561, 1975-2 C.B. 129. *See also* notes 78-91 *supra* and accompanying text.

[113]Estate of Stauffer v. Comm'r, 403 F.2d 611, 617 (9th Cir. 1968).

[114]S. Rep. No. 1622, 83d Cong., 2d Sess. 52, *reprinted in* [1954] U.S. Code Cong. & Ad. News 4683 (1954).

[115]63 T.C. 27 (1974).

a taxpayer merged its wholly owned subsidiary into its parent corporation and thereafter incurred net operating losses. The court allowed the taxpayer to carry back this net operating loss to the pre-merger taxable income of the transferor corporation since, with minor exceptions, there was no change in enterprise assets or personnel. The dissenting judge in *Eastern*, who would have disallowed the net operating loss carryback, construed section 368(a)(1)(f) as not encompassing the merger of two taxable entities.[116]

D. The Continuity of Interest Requirement in "F" Type Reorganizations

> *Example 13:* *P* Corporation owned seventy-eight percent of *S* Corporation. In prior years *S* had generated substantial operating profits. *P* bought out the twenty-two percent minority interest in merging *S* into *P*. During the next fiscal year, *S* incurred substantial net operating losses. *P* wishes to carry back these net operating losses against *S*'s prior years' taxable income.
> *Issue:* Can *P* successfully claim that this merger is an "F" type in order to carry back the net operating loss even though there has been a change in ownership of the entity that generated the net operating loss?

As previously mentioned, Revenue Ruling 75-561 requires that in order for a reorganization to qualify as an "F" type there must be a complete identity of shareholder interests between the transferor and the acquiring corporation.[117] Therefore, in *Example 13*, *P* Corporation would not be allowed to carry back *S* Corporation's post-merger net operating loss since the merger resulted in a break of the continuity of ownership. In *Aetna Casualty & Surety Co. v. United States*,[118] the Court of Appeals for the Second Circuit expressly rejected this continuity of ownership requirement set forth in Revenue Ruling 75-561. The court held that the merger of a corporation's sixty-one percent owned subsidiary into the corporation's newly-created and wholly-owned subsidiary nevertheless qualified as an "F" type reorganization even though the thirty-nine percent minority interest was eliminated.[119]

The *Aetna* decision was premised upon *Reef Corporation v. Com-*

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[116] *Id.* at 38 (dissenting opinion).

[117] *See* note 77 *supra* and accompanying text.

[118] [1976] STAND. FED. TAX REP. (CCH) (77-1 U.S. Tax Cas.) ¶ 9120, *rev'g*, 403 F. Supp. 498 (D. Conn. 1975).

[119] *Id.*

missioner.[120] In *Reef* the Commissioner successfully argued that the transaction at issue was not a liquidation-reincorporation, but rather a redemption of a minority interest governed by section 368(a)(1)(f) and section 302. Thus, the change in ownership in *Reef*, by way of the redemption, did not preclude the finding that the transaction qualified as an "F" type reorganization.[121] Similarly, the same principle was applied in *Aetna* in lieu of the strict ownership requirements set forth in Revenue Ruling 75-561.

Aetna limited its holding to situations involving "F" type reorganizations. The court required that the new corporation continue without interruption of the old. In addition, the court required that shareholders of the new corporation hold at least fifty percent of the old entity. Finally, the court stated that new shareholders may not be admitted during the reorganization.[122]

Aetna would permit *P* Corporation of *Example 13* to carry back *S* Corporation's post-merger net operating loss to *S*'s pre-merger taxable income. However, the other requirements set forth in *Aetna* and Revenue Ruling 75-561 must also be followed: (1) The business enterprise of the two entities must continue unchanged after the combination, (2) the merging entities must be in the same integrated activity prior to combination, and (3) the acquiring corporation which desires to carry back the transferor's post-merger net operating losses to the transferor's pre-merger taxable income must show that these net operating losses are attributable to a separate division or business formerly operated by the transferor corporation.

V. Conclusion

As the foregoing analysis reveals, determining the availability of net operating loss benefits that exist after corporate purchases and reorganizations is a complex task. Corporate planners dealing with these transactions should possess a general knowledge of the concepts and underlying legislative intent concerning the net operating loss deduction, a firm understanding of the intricate rules controlling the availability of these tax benefits, and an awareness of the changes made by the Tax Reform Act of 1976.

The controversy surrounding the utilization of net operating losses as carrybacks in corporate reorganizations primarily concerns the "F" type reorganization. The initial problem is determining what constitutes an "F" type reorganization in a given transaction. The

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[120]368 F.2d 125 (5th Cir. 1966), *cert. denied*, 386 U.S. 1018 (1967).

[121]*Id.* at 138.

[122][1976] Stand. Fed. Tax Rep. (CCH) (77-1 U.S. Tax Cas.) ¶ 9120, *rev'g* 403 F. Supp. 498 (D. Conn. 1975).

importance of this question is attributable to the rule which permits the carryback of post-merger net operating losses in this one type of reorganization only. In addition, the use of an "F" type reorganization as a planning tool for utilizing net operating loss carrybacks is substantially increased by the decision in *Aetna Casualty & Surety Co. v. Commissioner*,[123] which tolerates a material change in ownership in a corporation yet still permits the "F" type status. The second problem, given an "F" type status, is to determine whether the "attribution" rules set forth by the Commissioner and in recent court decisions have been satisfied.

The problem concerning the availability of net operating loss carryovers in purchase transactions is equally perplexing. The continuity of business doctrine, which was repealed by the Tax Reform Act of 1976, has been the most frequent source of litigation in this area. Since the new Act has delayed effective dates for the abrogation of this doctrine, and the dockets of many courts are severely backlogged, the demise of the continuity of business doctrine is still far down the road. In this regard, corporate planners must still be aware of the intricate rules set forth in the above examples.

As for future tax planning, the Tax Reform Act will only require that the continuity of interest of a transacting corporation be preserved. Not only will this place purchases on an equal footing with reorganizations, but it will also eliminate the bulk of confusion resulting from the continuity of business doctrine.

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[123] *Id.*

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